

AD-A246 377



② ✓

NAVAL POSTGRADUATE SCHOOL Monterey, California



DTIC
ELECTE
S **D**
FEB 18 1992

THESIS

AN EXAMINATION OF THE COST REIMBURSEMENT
POLICIES AND PROCEDURES FOLLOWED BY DOD
WHEN PROVIDING SERVICES TO
PRIVATE ORGANIZATIONS

by

Michael David Conn
June 1991

Thesis Advisor:

Kenneth J. Euske

Approved for public release; distribution is unlimited

92 2 14 139

92-03987



UNCLASSIFIED

SECURITY CLASSIFICATION OF THIS PAGE

REPORT DOCUMENTATION PAGE				
1a. REPORT SECURITY CLASSIFICATION UNCLASSIFIED			1b. RESTRICTIVE MARKINGS	
2a. SECURITY CLASSIFICATION AUTHORITY			3. DISTRIBUTION/AVAILABILITY OF REPORT Approved for public release; distribution is unlimited.	
2b. DECLASSIFICATION/DOWNGRADING SCHEDULE				
4. PERFORMING ORGANIZATION REPORT NUMBER(S)			5. MONITORING ORGANIZATION REPORT NUMBER(S)	
6a. NAME OF PERFORMING ORGANIZATION Naval Postgraduate School		6b. OFFICE SYMBOL (If applicable) 55		7a. NAME OF MONITORING ORGANIZATION Naval Postgraduate School
6c. ADDRESS (City, State, and ZIP Code) Monterey, CA 93943-5000			7b. ADDRESS (City, State, and ZIP Code) Monterey, CA 93943-5000	
8a. NAME OF FUNDING/SPONSORING ORGANIZATION		8b. OFFICE SYMBOL (If applicable)		9. PROCUREMENT INSTRUMENT IDENTIFICATION NUMBER
8c. ADDRESS (City, State, and ZIP Code)			10. SOURCE OF FUNDING NUMBERS	
			Program Element No	Project No
			Task No	Work Unit Accession Number
11. TITLE (Include Security Classification) AN EXAMINATION OF THE COST REIMBURSEMENT POLICIES AND PROCEDURES FOLLOWED BY DOD WHEN PROVIDING SERVICES TO PRIVATE ORGANIZATIONS.				
12. PERSONAL AUTHOR(S) CONN, MICHAEL D.				
13a. TYPE OF REPORT Master's Thesis		13b. TIME COVERED From To		14. DATE OF REPORT (year, month, day) JUNE, 1991
15. PAGE COUNT 170				
16. SUPPLEMENTARY NOTATION The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.				
17. COSATI CODES			18. SUBJECT TERMS (continue on reverse if necessary and identify by block number)	
FIELD	GROUP	SUBGROUP	COST REIMBURSEMENT POLICIES	
19. ABSTRACT (continue on reverse if necessary and identify by block number)				
<p>This thesis examines the billing policies followed by the Department of Defense (DOD) in recovering costs incurred from providing services to private enterprises. Examples studied include DoD assistance provided to the Paramount Pictures Corporation in the production of the motion pictures <i>Top Gun</i> and <i>The Hunt for Red October</i>, as well as to the Exxon Corporation for assistance provided in the Exxon Valdez oil-spill cleanup.</p> <p>Although the purposes for the assistance provided in each case were unique, the types of resources used (i.e., ships, aircraft, and personnel) were the same. Due to differences in DoD billing policies, DoD did not seek the same reimbursements from both corporations. For example, DoD required reimbursements from Exxon for all military personnel costs incurred in the Exxon Valdez case, but not from Paramount Pictures for similar costs in <i>The Hunt for Red October</i> production. Inconsistencies were also found in the implementation of the various policies by the DoD Components involved. If uniformity and consistency in billing procedures are to be attained, additional billing guidance and policy revisions are required.</p>				
20. DISTRIBUTION/AVAILABILITY OF ABSTRACT			21. ABSTRACT SECURITY CLASSIFICATION	
<input type="checkbox"/> UNCLASSIFIED/UNLIMITED <input type="checkbox"/> SAME AS REPORT <input type="checkbox"/> DTIC USERS			UNCLASSIFIED	
22a. NAME OF RESPONSIBLE INDIVIDUAL Professor Kenneth J. Euske			22b. TELEPHONE (Include Area code) (408) 646-2860	
			22c. OFFICE SYMBOL AS/EE	

DD FORM 1473, 84 MAR

83 APR edition may be used until exhausted
All other editions are obsolete

SECURITY CLASSIFICATION OF THIS PAGE

Approved for public release; distribution is unlimited.

An Examination of the Cost Reimbursement Policies and
Procedures Followed by DoD When Providing
Services to Private Organizations

by

Michael David Conn
Lieutenant, United States Navy Reserve
B.S., University of Illinois, 1983

Submitted in partial fulfillment
of the requirements for the degree of

MASTER OF SCIENCE IN FINANCE

from the

NAVAL POSTGRADUATE SCHOOL
June, 1991

Author:



Michael David Conn

Approved by:



Kenneth J. Euske, Thesis Advisor


James M. Fremgen, Second Reader
David R. Whipple, Chairman

Department of Administrative Sciences

ABSTRACT

This thesis examines the billing policies followed by the Department of Defense (DoD) in recovering costs incurred from providing services to private enterprises. Examples studied include DoD assistance provided to the Paramount Pictures Corporation in the production of the motion pictures *Top Gun* and *The Hunt for Red October*, as well as to the Exxon Corporation for assistance provided in the *Exxon Valdez* oil-spill cleanup.

Although the purposes for the assistance provided in each case were unique, the types of resources used (i.e., ships, aircraft, and personnel) were the same. Due to differences in DoD billing policies, DoD did not seek the same reimbursements from both corporations. For example, DoD required reimbursements from Exxon for all military personnel costs incurred in the *Exxon Valdez* case, but not from Paramount Pictures for similar costs in *The Hunt for Red October* production. Inconsistencies were also found in the implementation of the various policies by the DoD Components involved. If uniformity and consistency in billing procedures are to be attained, additional billing guidance and policy revisions are required.

TABLE OF CONTENTS

I. INTRODUCTION

A. BACKGROUND.....	1
B. THESIS SCOPE AND OBJECTIVES.....	3
C. RESEARCH AND METHODOLOGY.....	4
D. ORGANIZATION OF STUDY.....	5

II. DOD INVOLVEMENT IN THE PRODUCTION OF THE MOTION PICTURE TOP GUN

A. INTRODUCTION.....	7
B. BACKGROUND.....	7
C. DOD BILLING AND COST ACCOUNTING PROCEDURES.....	9
D. SUMMARY.....	31

III. DOD COSTING POLICY REVISION AND IMPLEMENTATION

A. INTRODUCTION.....	33
B. BACKGROUND.....	33
C. AUDIT FINDINGS AND RECOMMENDATIONS.....	34
D. THE OSD(PA) RESPONSE TO AUDIT RECOMMENDATIONS....	39
E. REVISION OF DODINST 5410.16.....	41
F. SUMMARY.....	47

**IV. DOD INVOLVEMENT IN THE PRODUCTION OF THE
MOTION PICTURE THE HUNT FOR RED OCTOBER**

A. INTRODUCTION.....	49
B. BACKGROUND.....	49
C. DOD BILLING AND COST ACCOUNTING PROCEDURES.....	51
D. SUMMARY.....	67

**V. DOD SUPPORT OF THE EXXON VALDEZ OIL SPILL
CLEANUP OPERATION**

A. INTRODUCTION.....	70
B. BACKGROUND.....	70
C. GOVERNMENT BILLING AND REIMBURSEMENT POLICIES FOLLOWED DURING THE CLEANUP OPERATION.....	73
D. GOVERNMENT COSTS INCURRED AND REPORTED IN SUPPORT OF THE CLEANUP EFFORT.....	81
E. COST REIMBURSEMENTS MADE BY EXXON.....	83
F. AGENCIES REIMBURSED BY COAST GUARD FOR LESS THAN THE RECOVERIES RECEIVED FROM EXXON.....	85
G. DOD BILLING PROCEDURES FOLLOWED AND THE COSTS INCURRED IN SUPPORT OF THE CLEANUP EFFORT.....	87
H. REVIEW OF UNITED STATES NAVY SUPPORT FOR THE EXXON VALDEZ OIL SPILL CLEANUP OPERATION.....	92
I. SUMMARY.....	104

VI. ANALYSIS OF THE COST REIMBURSEMENT POLICIES AND PROCEDURES FOLLOWED IN ASSESSING PARAMOUNT PICTURES AND EXXON FORDOD ASSISTANCE PROVIDED	
A. INTRODUCTION.....	106
B. BACKGROUND.....	107
C. USE OF WRITTEN AGREEMENTS.....	107
D. BILLING PRACTICES.....	112
E. POSSIBLE JUSTIFICATIONS FOR INCONSISTENCIES IN COST REIMBURSEMENT POLICY FOLLOWED BY DOD.....	129
F. LACK OF STANDARDIZATION IN DOD BILLING PROCEDURES.....	135
G. SUMMARY.....	139
VII. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS	
A. SUMMARY.....	141
B. CONCLUSIONS.....	143
C. RECOMMENDATIONS.....	147
D. SUBJECTS RECOMMENDED FOR FURTHER RESERACH.....	149
APPENDIX A - HOURLY RATES FOR MILITARY PERSONNEL ASSISTANCE (TOP GUN).....	152
APPENDIX B - SAMPLE OF REIMBURSEMENT AGREEMENT.....	153
APPENDIX C - DOD REQUIREMENTS LIST.....	154
LIST OF REFERENCES.....	155
INITIAL DISTRIBUTION LIST.....	163

I. INTRODUCTION

A. BACKGROUND

There are numerous sources of policy guidance and detailed billing procedures available that cover transactions in which the Government purchases or contracts for services and material from private organizations. However, these same sources provide little guidance, if any, for billing procedures to follow during those instances in which the provider of services is the government and the recipient is a private, nondefense enterprise.

This thesis involves an examination of the policies and billing practices followed by DoD, with particular emphasis on the United States Navy, when providing services to

1. The Paramount Pictures Corporation for the filming of the motion pictures *Top Gun* and *The Hunt for Red October* and
2. The Exxon Corporation in support of the *Exxon Valdez* oil spill cleanup operation.

The Chief of Information (CHINFO) and the Navy Office of Information, West (NAVINFO West) are the principal overseers of

DoD involvements with the entertainment industry. These two organizations implement the policies and guidances mandated in the two principle DoD instructions (DODINST) which provide specific policies for assisting non-government agencies in commercial productions. NAVINFO West receives from 200 to 250 script proposals each year and selects, on average, one per year to receive DoD production assistance. Once a script is chosen, NAVINFO West serves as liaison with the production company, coordinating services to be provided, as well as billing procedures to be followed by all DoD components participating.

With respect to the *Exxon Valdez* cleanup, The Clean Water Act and The National Contingency Plan are the principal policy statements which authorize and prescribe this type of Federal Government response to a major oil spill. These guidelines designate the United States Coast Guard as the agency responsible for overseeing such operations, including implementation of procedures for the reimbursement of costs incurred by federal agencies participating in the cleanup effort.

B. THESIS SCOPE AND OBJECTIVES

This thesis involves an analysis of the policies governing the billing procedures used in recovering the costs incurred in providing services to these two private organizations. This includes an examination of the differences in billing procedures which resulted under each of the applicable policies.

The thesis includes an assessment of the two DoD instructions governing the assistance provided in the two motion picture productions. DODINST 5410.16, dated January 21, 1964, was revised and implemented on January 26, 1988 after the filming of *Top Gun*, but before negotiations began for *The Hunt for Red October*. The billing procedures used in the two productions are compared in order to identify changes that took place following the DoD policy revision. These billing procedures are, in turn, compared with those followed in the *Exxon Valdez* case in order to determine what similarities and dissimilarities exist in deriving the charges assessed to each private corporation. Although other Services were involved in the three undertakings, this thesis focuses mainly on the policies and billing procedures followed by the United States Navy.

The General Accounting Office has also conducted audits which examine DoD assistance provided to both motion picture and television producers (focusing specifically on the *Top Gun* production) and to Exxon in the *Exxon Valdez* oil spill cleanup operation. The findings and recommendations presented in the audits are reviewed.

C. RESEARCH METHODOLOGY

The analysis performed for this thesis was based upon a combination of archival and empirical research. This included examination of billing documentation provided by CINCPACFLT, NAVINFO West, and CHINFO, as well as information obtained through telephone interviews with personnel from the Comptroller and Public Affairs Offices of the numerous DoD commands involved in each exercise. The Department of Defense was the primary source of information, since both the Paramount Pictures and Exxon Corporations considered the subjects confidential and turned down the author's request for any information concerning billing practices. The Office of the Comptroller of the Navy, as well as the CINCPACFLT Comptroller's Office, maintained detailed records for all three

cases. This enabled the author to obtain an accurate description of billing practices followed, despite the limitations created by the two corporations' reluctance to provide pertinent records.

D. ORGANIZATION OF STUDY

This thesis has seven chapters.

Chapter I includes introductory and background information and provides the reader with the objectives and scope of the thesis.

Chapter II provides a detailed examination of the DoD billing policy governing the assistance provided to Paramount Pictures in the production of the motion picture *Top Gun*. This includes a review of the costs incurred and the billing procedures followed by the United States Navy in providing this type of assistance.

Chapter III reviews changes made in DoD policy, after the *Top Gun* production, governing services provided to the entertainment industry. This includes an examination of the additional billing guidance provided, as well as the changes in reimbursement criteria, which were implemented through revision of DODINST 5410.16.

Chapter IV presents a detailed examination of the DoD billing policy governing the assistance provided to Paramount Pictures in the production of the motion picture *The Hunt for Red October*. This includes a review of the costs incurred and the billing procedures followed by the U.S. Navy in providing this type of assistance.

Chapter V describes the Federal Government's involvement in the *Exxon Valdez* oil spill cleanup operation, and the procedures followed in determining the costs to assess the Exxon Corporation for assistance provided. Also included is an examination of the reimbursement process administered by the U.S. Coast Guard.

Chapter VI provides a comparison of the policies and billing procedures followed in each of the three cases. This includes an examination of the dissimilarities in policy regarding charges assessed to each of the private parties, as well as the inconsistencies found in policy implementation. Possible justifications for the differences in policy are discussed.

Chapter VII summarizes the conclusions, based on the analysis presented in Chapter VI, and then provides recommendations for possible improvements and suggests topics for further research.

II. DOD INVOLVEMENT IN THE PRODUCTION OF THE MOTION PICTURE TOP GUN

A. INTRODUCTION

This chapter examines the procedures followed by the United States Navy in determining the costs to assess the Paramount Pictures Corporation for assistance provided in the filming of the motion picture *Top Gun*.

Offered first is a brief explanation of the Navy's involvement with Paramount Pictures, as well as the Department of Defense (DoD) policies governing this type of assistance to private organizations. This is followed by a detailed examination of the various components of costs involved and the procedures used to derive the charges assessed for DoD support in this production.

B. BACKGROUND

United States Navy involvement with Paramount Pictures in the filming of *Top Gun* began in October 1984 when producers Donald Simpson and Jerald Bruckheimer presented the Navy Office of

Information West (NAVINFO West) with the initial script proposal. The final screenplay was approved by the Assistant Secretary of Defense for Public Affairs (ASD(PA)) and filming began in late June 1985. NAVINFO West served as project coordinator and assigned a project officer to the *Top Gun* production. This project officer coordinated Navy assets in San Diego, CA, Fallon, NV, and on four aircraft carriers (three at sea) for filming which continued intermittently through November 1985. (NAVINFO West, August 4, 1986) As directed by Chief of Information, Washington D.C. (CHINFO), NAVINFO West coordinated billings for all Navy commands through the Commander in Chief, Pacific Fleet (CINCPACFLT) Comptroller. (CHINFO, 281721Z JUN 85)

For production assistance provided by the United States Navy, the Paramount Pictures Corporation paid reimbursements in the amount of \$1,241,902.48 (NAVINFO West, March 1, 1988). The motion picture *Top Gun* opened in theaters across the United States on May 16, 1986 and by January 6, 1988 had accumulated a total gross of \$171,626,614.00 (Hollywood Reporter, January 6, 1988, p. 59).

The following is an analysis of the policy and cost accounting procedures observed by the United States Navy in providing this atypical assistance to Paramount Pictures.

C. DOD BILLING AND COST ACCOUNTING PROCEDURES

Department of Defense Instruction (DODINST) 5410.16 dated January 21, 1964, DODINST 5410.15 dated November 3, 1966, and the Navy Comptroller Manual (NAVCOMPT) were the main sources of policy in effect during the time DoD was involved in the *Top Gun* production. DODINST 5410.16, *Procedures for DoD Assistance on Production of Non-Government Motion Pictures and Television Programs*, stipulates that commitment of DoD assistance can only be made after the ASD(PA) has reviewed and evaluated the script, and only after a detailed list of the production company's envisioned requirements for DoD assistance is prepared. DoD cost estimates and billing procedures are based upon this list of requirements. Even with these general prerequisites, the military services, in effect, provide assistance for movie and television productions without either a written agreement specifying the assistance to be provided

or the terms of reimbursement for that assistance. (Inspector General, 1986)

DODINST 5410.16 also authorizes the military services to assign project officers who are responsible for maintaining liaison with the production company, the ASD(PA), and the various services that provide assistance. The only reference to costs reimbursements found in the instruction pertains to expenses attributed to the services of the project officer. It states:

Assignment will be at no additional costs to the Government. The producing company will assume the payment of such items as travel and room and board. (DODINST 5410.16, Incl. 2)

The instruction further mandates that the project officer is to submit weekly reports which will include an accounting of expenses, but it offers no guidance on how to establish the amount of expenses incurred by the Government (DODINST 5410.16, Inclosure 2).

DODINST 5410.16 implements authority contained in DODINST 5410.15 of January 21, 1964, which was updated and replaced on November 3, 1966. Both the old and revised instructions are entitled *Delineation of DoD Audio-Visual Public Affairs Responsibilities and Policies*. The revised instruction provides additional guidance as to

DoD policy regarding what actual assistance requires reimbursement. Section V, paragraph E of this instruction states:

Diversion of equipment, personnel, and material resources from normal military locations or military operations may be authorized only when circumstances preclude filming without it, and such diversions shall be held to a minimum and without interference with military operations, and will be on the basis that the production company will reimburse the Government for expenses incurred in the diversion (DODINST 5410.15, November 3, 1966).

However, DODINST 5410.15 does not define "diversion" nor does it provide examples to guide billing activities. According to the DoD Inspector General audit report, billing practices are not standardized because DoD policies on billing have not been clearly defined. (Inspector General, 1986)

The DoD Instructions briefly described above, along with the NAVCOMPT Manual, were the main sources of guidance in effect in October, 1985 when Paramount Pictures first requested DoD assistance in the production of the motion picture *Top Gun*. In accordance with this guidance, the Chief of Information (CHINFO) informed all commands providing assistance in the *Top Gun* production that

U.S. Government expense incurred by diversion of equipment, personnel, and material resources from normal military

locations or military operations as a result of authorized assistance to motion picture producers must be reimbursed by the production company. (CHINFO 281721Z JUN 85)

CHINFO instructed all participating commands "...to document all, repeat all, expenses incurred during production assistance...."

This included all direct and indirect costs such as civilian labor, military personnel services, costs of material and supplies, travel expenses, utilities, maintenance of property and equipment, asset use and administrative charges. (CHINFO 281721Z JUN 85, p. 2)

To collect these reimbursements and to ensure the accurate accounting for payments for material and services furnished, the NAVCOMPT Manual prescribes three available methods: (Volume 3, paragraphs 032102 and 032109)

1. Collection of charges as fees in advance of rendering services or material, if practical.
2. Use of accounts receivable collection procedures when multiple requests for services are received on a continuous basis.
3. The use of an irrevocable letter of credit or surety payment bond in lieu of an advance deposit.

Due to the late receipt of Paramount Picture's production requirements, the U.S. Navy waived normal requirements that Navy commands provide advance estimates of charges for assistance requested (CHINFO 281721Z JUN 85 p. 2). CHINFO judged option 3 to be the most viable method for billing and on August 14, 1985 Paramount authorized the issue of an irrevocable letter of credit through the NCNB International Bank in New York, a subsidiary of the NCNB National Bank of North Carolina. (CINCPACFLT, July 19 1985)

The letter of credit number 33035 was in the amount of \$1.5 million and was valid through December 31, 1985. The Paramount Pictures Corporation was designated as payee, with Commander in Chief, US Pacific Fleet, Fleet Comptroller Office, named as beneficiary. The terms of the letter specified that Paramount would make payments within ten business days of receipt of a properly screened invoice from the CINCPACFLT Comptroller. If payments were not received within this time frame, the Department of the Navy was authorized to draw against the letter of credit. (Wattles, July 15, 1985, p. 1)

The Department of the Navy requested a minimum of two months to prepare and present a final invoice following the conclusion of the use of Navy facilities and services. The irrevocable letter of credit would remain in effect until at least twenty days had elapsed from presentation of the final invoice. Both parties agreed that the letter of credit could be amended to extend its duration if necessary to meet the foregoing requirements. (Wattles, July 15, 1985, p. 1)

Although the NAVCOMPT Manual provides detailed procedures for collecting reimbursements, the same level of guidance could not be found concerning requirements for "hold harmless" or indemnification agreements. In fact, a review of Navy regulations and DoD instructions in effect at the time of the *Top Gun* production failed to disclose any requirements for this type of insurance agreement. Nevertheless, Paramount Pictures issued an indemnification agreement on February 11, 1986 which expressly agreed to

...indemnify the United States up to an amount not to exceed twenty-five million dollars for any damage to property of the United States or others, or for personal injury (including death) to any person or persons proximately caused by the fault or negligence of Paramount, its agents, employees, or subcontractors ... (Wattles, February 11, 1986)

DoD policy does not provide guidance for indemnification agreements governing situations where Government equipment is lost or damaged by Government personnel during its use in a production (Inspector General, 1986, p.10). The *Top Gun* indemnification agreement restricted Paramount's liability to damage or injuries caused only by its own negligence. Two situations occurred during the filming of *Top Gun* that drew attention to the narrow scope of this agreement. In September 1985, a Navy radio valued at \$18,700 was lost in the ocean by Navy personnel during the filming of an at sea rescue scene. Paramount refused to pay for the lost radio because the loss was not due to its own negligence. The second situation involved damage to an F-14A Tomcat as a result of modifications made by the Navy at the producer's request. The Tomcat was temporarily non-operational as a result of electrical problems caused by the installation of five cameras which were used to film *Top Gun* flying scenes. Although Paramount paid for the modifications, it was reluctant to reimburse the Navy for the costs of the required repairs. The production company did eventually agree to pay for these expenses. (Inspector General, 1986, p. 11)

Once the letter of credit and the indemnification agreement had been issued, CINCPACFLT tasked COMNAVAIRPAC (Commander Naval Air Force, Pacific) to act as its purchasing services coordinator. COMNAVAIRPAC in turn designated COMFITAEEWWINGPAC (Commander Fighter Airborne Early Warning Wing, Pacific) as overall production coordinator and cost collection agent for AIRPAC commands. All other activities incurring costs for production reported directly to CINCPACFLT (COMNAVAIRPAC 011258Z, JUL 85).

With weekly status reports due to CINCPACFLT no later than the Wednesday following the week reported, COMFITAEEWWINGPAC established its own weekly reporting schedule. Based on Paramount's work week of Sunday through Saturday, reports from participating commands were due by the close of business each Monday following the week reported. COMFITAEEWWINGPAC required these reports to be in the following format: (COMFITAEEWWINGPAC, 192000Z JUL 85)

1. Steaming Hours (Ship type/Hull Number/Steaming Hours/Date)

Example: CV/63/3 Plus 40/30 Jun 85

2. Flying Hours (Type of Aircraft/Model/ParentCommand/Flight Hours/Date) Example: F14A/VF-1/1.2/30 Jun 85

3. Military/Civilian Personnel Charges (Rate-Rank/Parent Command/Service Performed/Time in Minutes/Cost/Date)

Example: E-4/VF-1/Install RH Brake/90 Mins/\$21.55/5 Jul 85

4. Special Charges (Type of Service or Equipment/Hours of Operation/ Parent Command/Cost, including surcharges/Date)

Example: JG75 Tractor/5 Plus 30/NAS Miramar/\$350/5 Jul 85

5. Brief narrative of how the costs were incurred

6. Unit action officer with phone number

The following is an explanation of the DoD guidance provided and the methodology used to determine the costs for each of the cost categories.

1. Steaming Hours

Charges for ship's operations were based on an eighteen hour day as prescribed in the Navy Program Factors Manual (NPFM). Commands were instructed to report only those hours, including whole minutes, in which the ships were deployed specifically for the purpose of providing production assistance to Paramount Pictures (COMFITAEEWWINGPAC, 192000Z JUL 85, p. 2, para 2A). NAVINFO West stated that hourly rates for ship operations were not

developed, since no deployment time was directly attributable to the *Top Gun* Production (Sherman, NAVINFO West, March 21, 1991).

2. Flight Hours

Two issues were raised when NAVINFO West requested guidance in charging Paramount Pictures for the use of Navy aircraft and related equipment. First, the Navy did not have established flight hour rates for the various aircraft Paramount Pictures had requested to use in the production. Second, the Department of Defense had no established or published operating cost data for pricing aircraft support and services provided to foreign governments and private parties. The Navy Comptroller's Office proposed that standard, annually updated, hourly rates be issued by The Office of the Secretary of Defense (OSD) to the various military departments. Proposed rates would include the charges to assess private parties and foreign governments for the use of fixed wing aircraft services. Under this approach, significant differences in rates between departments or within the same department could be avoided. OSD advised that the Services should jointly undertake the development of these reimbursable rates. (Navy Accounting and Finance

Memorandum, March 12, 1985) To date, DoD still relies on the individual military branches to develop their own standard flight hour rates (Strub, OASD(PA), February 21, 1991).

The Office of the Navy Comptroller developed charges specifically to assess Paramount Pictures for each of the various aircraft used in *Top Gun*. These rates were based on information from the most current Navy Program Factors Manual and cost data provided by COMNAVAIRPAC. These rates included charges not only for officer and enlisted personnel services, such as piloting and maintenance, but also charges for replenishment spares, squadron annual TAD, engine overhauls, and indirect costs for logistics, base operations, recruiting, and training. (COMNAVAIRPAC, 011258Z JUL 85, p. 2) The military personnel cost component was derived by using current Navy Composite Standard Military Rates. Further explanation of this cost accounting procedure is provided in section C, which addresses military and civilian personnel costs.

Commands providing assistance itemized and reported each flight hour as either a sortie dedicated to the motion picture production (requiring reimbursement) or as a military training mis-

sion. No sorties were split between production assistance and training (COMNAVAIRPAC, 011258Z JUL 85, p. 2, para 2B). Table 1-1 provides the flight hour rates established for the aircraft Paramount Pictures originally considered using in the production (Boydston, March 6, 1987).

Table 1-1

<u>Aircraft Model</u>	<u>Reimbursable Rate per Flying Hour</u>
A-6	8,781.81
FA-18	8,005.00
F-14	7,600.00
CH-53E	7,371.00
E-2	5,448.37
F-5	4,262.66
C-1A	3,787.00
SH-3	3,220.18
T-2	2,850.77
UH-1	2,527.00
A-4	2,274.43
HH-46A	1,772.90
C-9B	1,566.00

In its 1986 *Report on the Audit of Assistance to Movie and Television Producers*, the DoD Inspector General reported that

Neither DoD instructions nor Army and Navy implementing regulations discuss the pricing of flying hours...Prices charged for the same types of aircraft varied by as much as \$2,380 per flying hour. (Inspector General, 1986)

Several illustrations of these variations were provided in the report. For example, CINCPACFLT billed Paramount Pictures \$2,274.43 per hour for the A-4 aircraft used in the *Top Gun* production in September 1985. In contrast, in October 1984 the United States Marine Corps billed the producer of the television miniseries *Space* only \$820 per hour for the same type aircraft - a difference of \$1,454.43. The Marine Corps Public Affairs Office in Los Angeles told the Inspector General's Office that this was the rate used to bill DoD users for the A-4 aircraft. (Inspector General, 1986, p. 8)

In December 1985, CINCPACFLT billed the producer of *Top Gun* at the non-government rate of \$2527.00 per flying hour for the UH-1 helicopter (Boydston, March 6, 1987). In October 1985, the Army Finance and Accounting Office at Fort Rucker, Alabama, billed the producer of *Time to Triumph* \$147.00 - a difference of \$2,380.

(Inspector General, 1986, p. 9) These examples are presented to emphasize the lack of standardization among the Services and does not attempt to propose which rates are correct.

The methods which were followed to reimburse individual appropriations for flight hours assessed were dependent upon the particular type of aircraft used and the funding/management chain of command of the activity providing the aircraft. As examples, the percentage distributions among appropriation categories for the F-14A and the FA-18 are presented in Table 1-2 (Navy Accounting and Finance Memorandum, March 12, 1985 and COMNAVAIRPAC, 022058Z AUG 85).

Table 1-2

F-14A

<u>Appropriation #</u>	<u>Title</u>	<u>Dollar Amount</u>	<u>% of Total</u>
1751804.702A	OM&N	7,173.56	94.39
1751453.2201	MPN Officer	106.46	1.40
1751453.2202	MPN Enlisted	306.30	4.03
172499.00	Fees and Charges for Miscellaneous Services	<u>13.68</u>	<u>0.18</u>
Reimbursable Rate Per Flying Hour:		\$7,600.00	100.00%

FA-18

<u>Appropriation #</u>	<u>Title</u>	<u>Dollar Amount</u>	<u>% of Total</u>
1751804.702E	OM&N	4,523.00	56.50
1751804.4RZ9	Engine Overhaul/Re- placement Parts	917.00	11.45
1751453.2201	MPN Officer	625.00	7.81
1751453.2202	MPN Enlisted	1,401.00	17.50
173041.1206	Civilian	16.00	0.20
173041.1201	Asset Use Charge	299.00	3.74
173041.1201	Admin Surcharge	<u>224.00</u>	<u>2.84</u>
Reimbursable Rate Per Flying Hour:		\$8,005.00	100.00%

A total of nine types of Naval aircraft were required in the production. The Navy charged Paramount Pictures \$998,502.90 for the 188.9 flight hours flown. (Boydston, March 6, 1987)

3. Personnel Costs

a. Military Personnel Costs

Hourly rates for military personnel were determined by using the Navy Composite Standard Military Rates (CSMR) as prescribed in NAVCOMPT Manual 035750 AND NAVCOMPTNOTE 7041, dated March 7, 1985 (COMNAVAIRPAC 011258Z, JUL 85). A CSMR is separately computed for each pay grade in each of the military services. These rates are based on an established 40-hour work week, and 52 weeks, 260 days, or 2080 hours per year and provide

for those costs covered under the MPN appropriation (NAVCOMPT Manual 035750, para 1). These include basic pay, incentive pay, certain expenses and allowances, and special pay. Miscellaneous expenses and allowances are computed separately for officer and enlisted personnel and include items such as subsistence, uniform, and clothing allowances. Special pay refers to pay bonuses such as aircrew and submarine bonuses, hazardous duty, and special pay for physicians and dentists. When billing for military personnel is appropriate, the Navy Comptroller Manual prescribes two methods of computation: one for services provided to a non-Defense Federal agency and one for services provided to a non-Federal agency, state government, local government, private party, or Foreign Military Sales customer. (NAVCOMPT Manual 035750, para 3g). Both methods use the CSMR and include the application of adjustments called "acceleration factors" to provide for the accrual of "leave and holiday" and "other personnel support costs". Until January 1, 1985, the NAVCOMPT Manual also required the non-Federal agency rate to include an acceleration factor of 33 percent for the "retirement entitlement" accrual. After January 1, 1985, the retirement

entitlement accrual was incorporated into the CSMR.
(NAVCOMPTNOTE 7041, 7 MAR 85)

For personnel costs attributed to Paramount Pictures, each CSMR was adjusted by a leave and holiday rate of 14 percent and by a personnel support rate of 6 percent for officers and 18 percent for enlisted (COMNAVAIRPAC, 011258Z, JUL 85, p.3).

Because the Basic Allowance for Quarters (BAQ) rate is incorporated into the CSMR, both the NAVCOMPT Manual (035750, para 3c) and NAVCOMPTNOTE 7041.4(b) stipulate that

When quarters are provided free of charge by a non-DoD activity (private party or other Government agency), the BAQ rate will be deducted from the applicable composite standard military rate when billing military personnel services.

A differentiation was made between rates when Paramount Pictures provided quarters free of charge to military personnel and when they did not (COMNAVAIRPAC, 011258Z JUL 85, p. 3). An example of the billing computation used in the *Top Gun* production is provided in Table 1-3. The computed hourly rates for all pay grades are presented in Appendix A. Note that, when Paramount Pictures provided quarters, the BAQ rates were adjusted

by both the "leave and holiday" and the "other personnel support costs" accrual acceleration factors before being subtracted from the CMSR.

Table 1-3

	<u>Officer</u> <u>Pay Grade O-1</u>	<u>Enlisted</u> <u>Pay Grade E-7</u>
CMSR.....	\$16.20	\$18.41
Leave and Holiday Accrual.....	<u>X 1.14</u>	<u>X 1.14</u>
	\$18.47	\$20.99
Other Personnel Support		
Costs Accrual.....	<u>X 1.06</u>	<u>X 1.18</u>
Rate with DON Paying BAQ.....	\$19.58	\$24.77
Less BAQ Rate.....	<u>\$ 2.00</u>	<u>\$ 2.63</u>
Rate with Paramount Providing QTRS...	\$17.58	\$22.14

The personnel rates provided in Appendix A were employed when military personnel provided specific non-flight related assistance. Examples of these services include towing aircraft to static film locations or providing a security patrol to safeguard the production company's equipment. Personnel costs traceable to services provided for aircraft operations, maintenance, or base operating support were already encompassed in the cost per flying hour rates.

DoD policy guidance did not specify whether production companies should pay for the personnel costs of the project officers who provide extensive assistance to these productions. CINCPACFLT did not bill Paramount Pictures for the *Top Gun* project officer who devoted as much as 15 hours a day for two months to the production. (Inspector General, 1986, p. 9)

A special DoD policy was issued concerning military "extras". This policy required that all extras be volunteers and in a leave or liberty status. Volunteer extras both ashore and aboard ships at sea could not be paid. Military personnel filmed while performing normal duties and not providing any special assistance to Paramount were not considered as extras nor were they chargeable to Paramount Pictures. (CHINFO, 212240Z, JUN 85) However, the production company was expected to make donations to the Morale, Welfare and Recreation funds of those commands providing assistance.

Although the donations to command Morale, Welfare and Recreation funds were considered voluntary, evidence suggests that some pressure was required in persuading Paramount to contribute.

In a memo to Robert Manning (OI-22 CHINFO), the NAVINFO West *Top Gun* Project Officer writes:

Should Paramount not make donations, it could cause repercussions not only for future extras for their pictures, but other production companies as well. (Stairs, April 2, 1986)

On November 5, 1987, over a year and a half later, Paramount Pictures made a contribution of \$20,100. This was distributed among those commands that participated in the production of the motion picture (Sherman, December 1, 1987).

Upon completion of the production, Paramount Pictures was assessed \$35,279.84 for the military personnel assistance provided. (Boydston, March 6, 1987)

b. Civilian Personnel Cost

The same method was followed in determining charges assessed for services provided by civilian personnel. In accordance with the NAVCOMPT Manual, a retirement acceleration rate of 19.5 percent was applied to recover costs incurred by the Department of the Navy for retirement, medical, and life insurance expenses (NAVCOMPT Manual, Volume 3, 035875, para. 1b(2)1). Upon completion of the production, the United States Navy assessed

Paramount Pictures \$22,675.73 for civilian personnel costs.

(Boydston, March 6, 1987)

c. Temporary Additional Duty (TAD)

DODINST 5410.15 requires reimbursement for expenses incurred in diversion of personnel from normal military locations and operations. However, the Instruction does not provide guidance as to whether the reimbursements should include the full cost of salaries and benefits for those who are on temporary duty.

CINCPACFLT did not bill Paramount for the full costs of salaries and benefits of 40 enlisted personnel on temporary duty to assist in the production in August 1985. These 40 personnel were assigned to the Naval Air Station, Miramar, CA, but were on TAD orders to Naval Air Station, Fallon, Nevada, to service and maintain Navy aircraft performing choreographed aerial sequences for the production. Although the Inspector General's Office estimated that the salaries and benefits of these personnel amounted to approximately \$96,000, Paramount was billed only \$49,776 for the personnel services provided. (Inspector General, 1986, p. 10)

For Temporary Additional Duty required in the production, Paramount Pictures was billed \$25,782.59 (Boydston, March 6, 1987).

4. Special Charges

Special charges refer to assistance that exceeded ship and aircraft reimbursable charges. Examples include equipment rental, operation of auxiliary equipment such as a ship's boats and cranes, or flightline trucks performing other than normal operations. These charges were reported separately. (COMNAVAIRPAC, 011258Z JUL 85, p. 2, para 2C)

The NAVCOMPT Manual stipulates that, when a service or sale is made to private parties, a charge will be imposed to recover the full cost incurred by the Department of the Navy or the fair market value, whichever is higher (NAVCOMPT Manual, 035875, para1b(1)). In order to accomplish this, the NAVCOMPT Manual requires an asset use charge of 4 percent of direct costs be added to cover depreciation and interest on investment in DoD owned fixed assets, and that an administrative surcharge of 3 percent of total costs be added to cover general and administrative costs of the DoD

component (NAVCOMPT Manual, 035875, para 1b(2)4,6). The total amount CINCPACFLT charged Paramount for these special services, including the surcharges, was \$21,315.64 (Boydston, March 6, 1987).

D. SUMMARY

Table 1-4 provides a summary of the final costs the United States Navy charged Paramount Pictures for assistance provided in the production of the motion picture *Top Gun*. (Boydston, March 6, 1987)

Table 1-4

a. Aircraft.....	\$998,502.90
b. Material.....	1,022.13
c. Military Personnel.....	35,279.84
d. Civilian Personnel.....	22,675.73
e. Equipment Rental.....	20,293.51
f. Temporary Additional Duty.....	25,782.59
g. Telephone.....	134.15
h. Administrative Surcharge of 3% for items b through g.....	3,281.63
i. Replacement of Damaged Canopy.....	<u>134,930.00</u>
TOTAL:	<u><u>\$1,241,902.48</u></u>

After the Navy's involvement in the motion picture *Top Gun* was concluded, several significant changes took place with respect to DoD policy governing this type of assistance to private parties. These changes were embodied in the revised and updated DODINST 5410.16 of January 26, 1988. This revision was due, in part, to the findings and recommendations of the audit conducted by the DoD Inspector General in 1986. (Inspector General, 1986, pp. 11-14) The next two chapters examine these changes and the cost accounting procedures followed by the United States Navy in determining the costs to assess the Paramount Pictures Corporation for assistance provided in the filming of the motion picture *The Hunt for Red October*.

III. DOD COSTING POLICY REVISION AND IMPLEMENTATION

A. INTRODUCTION

This chapter examines revisions to DoD policy regarding DoD assistance provided to the entertainment industry, which took place following the completion of DoD involvement in Paramount Picture's production of the motion picture *Top Gun*. Offered first is a summation of the results of an audit conducted by the DoD Inspector General in 1985 and 1986 which examined this type of DoD assistance and which specifically concentrated on the Navy's involvement with the *Top Gun* production. This is followed by an examination of the changes made in DoD policy and guidance regarding the cost accounting and reimbursement procedures used when providing this type of assistance.

B. BACKGROUND

The DoD Inspector General conducted an audit from December 1985 to March 1986, which examined DoD assistance provided to

movie and television producers. The objectives of the audit were

...to determine if agreements with producers protected the interests of the government, to evaluate procedures and controls to recover costs of assistance, and to determine if disposition of reimbursement was proper. (Trodden, October 17, 1986, p. 2)

The audit focused mainly on the assistance provided by the Navy for the *Top Gun* production, which included a thorough examination of billing documentation and interviews with personnel from Navy and Air Force units that provided assistance. The following is an examination of the findings and recommendations provided in the Inspector General's *Report on the Audit of Assistance to Movie and Television Producers* (Report No. 87-008, 1986).

C. AUDIT FINDINGS AND RECOMMENDATIONS

The Inspector General concluded that reimbursements made by Paramount Pictures for services provided by the Navy in the *Top Gun* production were received in accordance with existing DoD policies. However, the Inspector General stressed the need for "...clarification of DoD policies regarding written agreements and the pricing of assistance provided to producers" (Trodden, October 17, 1986, p. 1).

1. Written Sales Agreements

In examining past DoD involvement with the entertainment industry, the Inspector General found that

From 1979 through 1985, the Services provided assistance for seven movie or television productions without written sales agreements specifying the assistance to be provided and the reimbursement terms... DoD instructions on assistance to movies and television producers do not require the Services and the producers to sign a contract or a formal agreement specifying the assistance to be provided and the reimbursement terms. (Inspector General, 1986)

The Inspector General stated that the lack of a written agreement contributed to a dispute between the Government and the producers of the 1979 movie *Final Countdown* and also to a civil suit filed by the Department of Justice against a former Navy squadron commander and the producers of *Final Countdown* for conspiracy to defraud the Government and breach of agreement. The Inspector General audit report stated:

Some issues in the suit might have been avoided if both parties had signed a written agreement covering the methods to be used in determining the number of reimbursable flying hours and the reimbursable cost of each flying hour. (Inspector General, 1986, p. 4)

The dispute in the *Final Countdown* production involved, in part, disagreement over the definition of a chargeable flying hour. The Government contended that billing for flying hours should include takeoffs, landings, airborne refueling, and flying the aircraft to filming locations. On the other hand, lawyers for the producers argued that the movie company had agreed only to reimburse the Navy for the cost of "flying scenes" (Inspector General, 1986, p. 4). There was also disagreement over the per-flight-hour cost of an F-14 fighter. The Government was suing to recover costs totaling \$691,105, based on the flight hour rate of \$4,126, while lawyers for the producers argued that the Navy's costs was only \$1,200 per flight hour. (Inspector General, 1986)

The *Top Gun* producers were billed for all flying hours, from takeoffs to landings, which were recorded as production support. The Inspector General reported that "these billing practices were correct and should be incorporated in DoD policy for all productions." (Inspector General, 1986, p. 7) Based on the above findings, the Inspector General recommended that

...the Assistant Secretary of Defense (Public Affairs) revise DoD Instruction 5410.16 to require the Services to negotiate written agreements with producers before the Services provide assistance for commercial productions. (Inspector General, 1986, p. 3)

The Inspector General recommended that these agreements include detailed descriptions of the assistance to be provided (both reimbursable and non-reimbursable), along with unit prices for each type of reimbursable support and the methods to be used in determining the final charges. (Inspector General, 1986, p. 4)

2. DoD Policy concerning Billing Practices

The Inspector General found that "billing practices were not standardized because DoD policies on billing have not been clearly defined". (Trodden, October 17, 1986) The DoD Inspector General concluded that this lack of standardization had resulted in large variations in the per-flight-hour rates charged private parties for the same types of aircraft used and, in the case of *Top Gun*, had resulted in failure to bill for the use of government cameras, assistance provided by public affairs officers, and the loss or damage of Navy property (Inspector General, 1986, p. 7). From an examination of billing procedures observed in the *Top Gun*

production, the Inspector General stated in the audit report that "Billing practices raised some questions that, in our opinion, should be resolved by more explicit DoD policy guidance". In particular, the Inspector General provided the OASD(PA) with seven "Recommendations for Corrective Action". (Inspector General, 1986, pp. 11-12)

These were as follows:

1. Require producers to pay for all flying hours related to production assistance including takeoffs, landings, and ferrying aircraft from military locations to filming sites.
2. Specify whether flying hour prices should include or exclude petroleum, oil, lubricants, maintenance, crew per diem, civilian pay, military pay, permanent change of station costs, asset use charges, and administrative charges.
3. Specify whether asset use charges should be charged for all equipment used to assist in movie or television productions.
4. Specify whether producers should be charged for the salaries and benefits of public affairs officers who provide extensive assistance to the producers.
5. Prescribe a method for billing for special personnel services that are related to aircraft flights but not covered in flying hour rates.
6. Specify whether producers should pay the full cost of the salary and benefits of personnel while they are on temporary assignment to provide production assistance.

7. Specify whether producers should pay for equipment damaged or lost by Government personnel while using the equipment to assist the producers.

The next section provides a review of the Office of the ASD(PA) response to these Inspector General recommendations.

D. The OSD(PA) RESPONSE TO AUDIT RECOMMENDATIONS

In a memorandum sent to the Assistant Inspector General for Auditing, the Office of the ASD(PA) agreed "in general" with the recommendations made in the audit report concerning written sales agreements and DoD billing practices. (Simms, August 6, 1986)

With respect to sales agreements, the ASD(PA) stated he intended to revise DODINST 5410.16 to require the Services to negotiate written agreements with motion picture and television producers before providing DoD assistance. (Simms, August 6, 1986).

However, the ASD(PA) also expressed that

...due to the nature of the television and motion picture industry which necessitates near-constant script revision, reshooting of scenes, weather unpredictability, etc., we would point out that such agreements need to be general rather than highly specific in their content. (Simms, August 6, 1986)

The ASD(PA) pointed out that DODINST 5410.16 already requires producers to provide a detailed requirements list upon which cost

estimates and billing procedures are based. However, the ASD(PA) acknowledged the need for standardization and additional guidance with respect to billing practices by stating:

DODINST 5410.15 should be revised to provide guidance on how to establish the amount of expenses incurred by the Government, define diversions of equipment, personnel or material resources, and to provide examples to guide billing activities. (Simms, August 6, 1986)

The ASD(PA) was concerned, however, that "procedures could become so restrictive or cost prohibitive as to discourage producers from seeking support" and that "it is in the best interest of the Government to support productions that portray the military in a positive and accurate light" (Simms, August 6, 1986). This same concern is also expressed in DODINST 5410.15, which requires that the production be authentic in its portrayal of military life (November 3, 1966, Section V, paragraph A1).

Aside from the concerns described above, the ASD(PA) concurred with all the Inspector General audit recommendations and stated:

Concerns raised in the draft audit will be addressed in revisions to DoD Instructions 5410.15 and 5410.16, which are expected to be published by the beginning of calendar year 1987. (Simms, August 6, 1986)

E. REVISION OF DODINST 5410.16

Due in part to the concerns raised by the DoD Inspector General in its *Report on the Audit of Assistance to Movie and Television Producers*, the ASD(PA) updated and revised the January 21, 1964 DODINST 5410.16. The revised DODINST 5410.16, dated January 26, 1988, is titled *DoD Assistance to Non-Government, Entertainment-Oriented Motion Picture, Television, and Video Productions*. The instruction incorporates most of the recommendations made by the Inspector General and provides additional guidance concerning Government reimbursements. Like its predecessor, the new instruction implements the authority contained in DODINST 5410.15. Similarly, both versions of 5410.16 require that the ASD(PA) approve not only the production company's script proposal but also a detailed Requirements Lists (described later) before DoD assistance is authorized (DODINST 5410.16, Para E.1d). However, unlike its predecessor, the revised DODINST 5410.16 also provides thirteen guidelines to aid DoD components in determining exactly what Government incurred costs require reimbursement. (DODINST 5410.16, E.4b) These guidelines are as follows:

- (1) Petroleum, oil, and lubricants for equipment used.
- (2) Resultant depot maintenance.
- (3) Expendable supplies.
- (4) Travel and per diem (unless paid directly to the member).
- (5) Civilian overtime.
- (6) Replenishment spares.
- (7) Lost or damaged equipment.
- (8) Commercial power or other utilities for facilities kept open beyond normal duty hours or in such cases where the consumption of utilities is significant.
- (9) Costs incurred in diverting or moving equipment to a specific location to support the production requirements.
- (10) All flying hours related to production assistance, including takeoffs, landings, and ferrying aircraft, except when such missions coincide with and can be considered legitimate operational and training missions.
- (11) The production company shall not be required to reimburse the Government for military or civilian manpower (except for civilian overtime) when such personnel are officially assigned to assist in the production.
- (12) Normal training and operational missions that would occur regardless of DoD assistance are not considered chargeable.
- (13) Beyond actual operational expenses, no charges shall be levied for asset usage (i.e., rental or depreciation factors).

These guidelines contain many of the recommendations presented in the Inspector General's audit report. Guideline number (7) addresses the issue raised by the Inspector General regarding the loss or damage of Government equipment. Guideline number (9) incorporates the recommendation for the clarification of "diversion" used in DODINST 5410.15. Guideline number (10) addresses the problem raised during the *Final Countdown* production regarding the definition of a reimbursable flight hour. Guideline number (11) demonstrates a change in DoD policy concerning the reimbursement of military and civilian personnel costs. The Defense Department no longer requires reimbursement for the costs incurred in providing personnel support in a motion picture or television production. This is a shift from the cost accounting procedures followed during the *Top Gun* production, in which DoD required Paramount Pictures to reimburse the Government for \$35,279.84 in military personnel costs and \$22,675.73 in civilian personnel costs. In a telephone conversation with the author, the Director of NAVINFO West stated :

We stopped charging for military and civilian personnel costs partly because we have so much artistic control over the productions, but also because the Navy would still be writing

the same paychecks whether we helped in the productions or not. (Sherman, telephone conversation, March 21, 1991)

Another change in DoD policy is expressed in Guideline number (13), which addresses the Inspector General recommendation for clarification of DoD policy regarding asset use charges. DoD now excludes any charges for asset usage. This, too, is a shift from procedures followed in earlier productions. For example, in the *Top Gun* production, CINCPACFLT charged Paramount for asset use when aircraft, tractors, and forklifts were used to assist in production. (Inspector General, 1986, p. 9). This asset usage charge was incorporated into the flight hour and equipment rental rates developed specifically for the *Top Gun* production.

In addition to providing the thirteen billing guidelines described above, the revised DODINST 5410.16 also differs from its predecessor by incorporating the Inspector General recommendation for written agreements. Paragraph C2 of the new instruction states:

The producer shall be required to sign a written "Reimbursement Agreement" with the appropriate DoD Component(s)... before receiving DoD assistance.

The revised DoD instruction provides a sample Reimbursement Agreement (Appendix B) which is to include a Requirements List

(Appendix C) similar to the one contained in the earlier instruction. Both versions of the Requirements List include a detailed description of exactly which Government assets will be required and when, where, and how they will be used in the production. However, the revised Requirements List replaces the last column in the 1966 version, entitled "Remarks", with a column specifically for "DoD Estimated Costs". Although the 1966 DoD instruction mandated the use of a Requirements List, it did not call for a formal agreement, signed by both parties, specifying reimbursement terms. The Reimbursement Agreement described in the 1988 instruction requires the production company "to abide by DODINST 5410.16" and authorizes "minor deviations" from the Requirements List, provided there is "mutual consent" between DoD and the production company. (DODINST 5410.16, January 26, 1988, p. 1-1)

In both the 1964 and 1988 versions of DODINST 5410.16, the ASD(PA) authorizes DoD components to provide assistance to producers prior to DoD approval of a script or, in the revised version, before the signing of a Reimbursement Agreement. The revised DODINST 5410.16 states

...DoD Components are authorized to assist non-Government producers, scriptwriters, etc., in their efforts to develop a script that might ultimately qualify for DoD assistance. Such activities could include guidance, suggestions, access for technical research, etc. (para D.2a)

In addition to the required Reimbursement Agreement, the revised DODINST 5410.16 contains two other requirements for assistance which were not included in the 1964 version. After the ASD(PA) approves a script and authorizes DoD assistance, the revised DODINST 5410.16 specifically mandates that the production company "post advance payment or a sufficient Letter of Credit to cover the estimated costs before receiving DoD assistance" (DODINST 5410.16.C2, p. 2). Although this has been the customary practice, as demonstrated in earlier productions, the ASD(PA) did not promulgate the requirement as DoD policy until the 1988 DoD instruction. The new instruction provides a sample Letter of Credit.

The second prerequisite is provided in paragraph C8 of the instruction. Here DoD policy requires the production company to provide "proof of adequate industry standard liability insurance" and to execute "Hold Harmless" agreements with each DoD component providing assistance in the production. Indemnification agreements

were already an established procedure, as demonstrated in earlier productions such as *Final Countdown* and *Top Gun*, although they were not specifically mandated in the 1964 DODINST 5410.16. The revised DoD instruction provides a sample Hold Harmless agreement which does not include the DoD Inspector General recommendation that such agreements address reimbursement by the production company for the loss or damage of equipment by Government personnel who are assisting in the production. (Inspector General, 1986, p. 11)

F. SUMMARY

The January 26, 1988 DODINST 5410.16 contains many of the same delegations of responsibilities and DoD production assistance requirements as its 1964 predecessor. However, the revised DoD instruction also includes recommendations suggested in the 1985 Inspector General audit: the thirteen billing guidelines, the Reimbursement Agreement, the revised Requirements List, the Letter of Credit, and the Hold Harmless agreement.

The next chapter examines how the changes embodied in the revised DODINST 5410.16 were later implemented, by examining the

cost accounting procedures used by the United States Navy in determining the costs to assess the Paramount Pictures Corporation for assistance provided in the filming of the motion picture *The Hunt for Red October*.

IV. DOD INVOLVEMENT IN THE PRODUCTION OF THE MOTION PICTURE *THE HUNT FOR RED OCTOBER*

A. INTRODUCTION

This chapter examines the procedures followed by the United States Navy in determining the costs to assess the Paramount Pictures Corporation for assistance provided in the filming of the motion picture *The Hunt for Red October*.

Offered first is a brief explanation of the Navy's involvement with Paramount Pictures, as well as the DoD policies governing this type of assistance. This is followed by a detailed examination of the various types of DoD costs involved and the procedures used to derive the charges assessed for DoD support in the production.

B. BACKGROUND

Paramount's motion picture *The Hunt for Red October* is based on Tom Clancy's best selling novel, which portrays a modern, high-tech Navy in the hunt for a Soviet skipper and his officer crew, who are defecting with one of the Soviet Union's most advanced nuclear submarines -- the Red October.

In December of 1988, the Office of the Assistant Secretary of Defense for Public Affairs (ASD(PA)) approved the screenplay and authorized DoD assistance in the production of *The Hunt for Red October* (Baruch, 1988). This assistance was subject to compliance with all requirements specified in DODINST 5410.16 dated January 26, 1988 (Baruch, 1988). The Navy Office of Information West (NAVINFO West) served as project coordinator and assigned a project officer to the production. Principal photography began on April 3, 1989 in the Puget Sound area, off Port Angeles, in the State of Washington. Filming continued through July 20, 1989, with three additional days of shooting required on November 22, December 10th and December 18th. Navy support involved, in part, the use of five submarines, four guided missile frigates, and one aircraft carrier. (NAVINFO West, February 2, 1990)

The motion picture *The Hunt for Red October* premiered on February 26, 1990 and as of February 1, 1991 had accumulated box office sales of \$131.5 million.(Hollywood Reporter, April 3, 1991) The Paramount Pictures Corporation paid reimbursements in the amount of \$325,215.11 for production assistance provided by the

United States Navy. (NAVINFO West, February 2, 1990, p. 6). The following is an analysis of the methods and the cost accounting procedures observed by the United States Navy in providing this type of assistance to Paramount Pictures.

C. DOD BILLING AND COST ACCOUNTING PROCEDURES

With respect to DoD transactions involving private parties, DODINST 5410.16 dated January 26, 1988, DODINST 5410.15 dated November 3, 1966, and the Navy Comptroller Manual were the main sources of guidance in effect when Paramount Pictures first requested assistance from the United States Navy in the production of *The Hunt for Red October*.

In *The Hunt for Red October After Action Report*, NAVINFO West described the Navy's involvement in this production by dividing the assistance given into three parts: (1) Pre-Production, (2) Principal Photography, and (3) Post-Production. The following is an examination of the cost accounting procedures implemented during each of these phases. (NAVINFO West, February 2, 1990, p.1)

1. Pre-Production

The script for *The Hunt for Red October* and Paramount Picture's initial Requirements List were approved by the ASD(PA) on December 27, 1988. Although DoD assistance was authorized, the ASD(PA) indicated that Paramount's initial request for assistance did not fully meet the requirements of DODINST 5410.16, since it did not describe, by scene, the military assistance requested or the expected costs to the Government (Baruch, 1988). In a memorandum from the OASD(PA), Office of the Assistant Secretary of Defense (Public Affairs), to the Chief of Information (CHINFO), the Special Assistant (Audiovisual) suggested

...that we receive the request for assistance from the company in the customary form, by scene references with appropriate notations about appropriate costs. ...Meanwhile, any filming of opportunity for stock or set design should be accommodated. (Baruch, 1988)

Based on this initial approval, Pre-Production meetings with NAVINFO West began in January 1989 and involved discussions on what particular Navy assets would be required, as well as the quality and extent of support needed.

As discussed in the previous chapter, once the ASD(PA) approves a script and authorizes DoD assistance, DODINST 5410.16 specifically mandates that, before receiving any additional DoD assistance, the production company must (1) sign a Reimbursement Agreement, and (2) post advance payment or a sufficient Letter of Credit to cover the expected costs (DODINST 5410.16, paragraph C2). NAVINFO West stated that a Reimbursement Agreement for *The Hunt For Red October* production was not necessary since an adequate Letter of Credit had been established by Paramount Pictures (NAVINFO West, January 22, 1991). To satisfy the second requirement, Paramount Pictures established a Letter of Credit in March of 1989, which was issued through the National Westminster Bank USA of New York. The Letter of Credit, number 301971, was in the aggregate amount of \$200,000 and was effective until August 31, 1989. (National Westminster Bank USA, 1989)

DODINST 5410.16 also requires that the production company execute Hold Harmless agreements with each DoD component assisting in the production (paragraph C8). Paramount Pictures established an all-inclusive Hold Harmless agreement, dated March

29, 1989, which agreed to

...indemnify the United States up to an amount not to exceed \$25,000,000 for any damage to property of the United States or others or for personal injury (including death) to any person or persons proximately caused by the fault or negligence of Paramount, its agents, employees, or subcontractors in connection with the production. (Kamon, 1989)

This indemnification agreement did not incorporate the recommendation made by the DoD Inspector General, which was to have the agreement address reimbursement by the production company for the loss or damage of equipment used by Government personnel assisting in the production. (Inspector General, 1986)

Once these prerequisites were satisfied, and after the ASD(PA) approved the script and Requirements List, CHINFO instructed those commands providing assistance in *The Hunt for Red October* to document all expenses in accordance with DODINST 5410.16 and to submit these charges to NAVINFO West upon completion of filming on site. NAVINFO West would then present consolidated charges to CINCPACFLT for preparation of billing to the Paramount Pictures Corporation. (CHINFO, 071429Z April 89)

During the pre-production phase, cast and production crews embarked in aircraft, surface ships, and submarines to research dialogue, costume and set design. Production designers visited Los Angeles Class nuclear submarines (SSN's) in San Diego, where they examined ship design and shot still photos in order to build a mock-up of the USS Dallas on the sound stage at Paramount. The photos and their negatives, along with submarine schematics of various areas of the ships, all underwent security review by such organizations as the Naval Sea Systems Command. Real Russian immigrants were employed by Paramount to add a sense of realism to the scenes. These Russian extras were required to undergo background checks, performed by the Naval Intelligence Service, in order to embark on Navy ships used in the production. (NAVINFO West, February 2, 1990)

Navy support in this phase also included required aviation and swim physiology for cast and crew members who would embark in helicopters. (NAVINFO West, February 2, 1990, A.3)

The United States Navy did not charge Paramount Pictures for any of the labor services and assistance described above. This

was based on the revised DODINST 5410.16, which no longer requires the production company to reimburse the Government for military or civilian labor expenses other than civilian overtime. (DODINST 5410.16, paragraph 4b11)

Based on this direction, the only labor charges assessed to Paramount Pictures for the entire production involved overtime expenses for six civilian employees needed to operate cranes provided by NAS Alameda and overtime for civilian tugboat crews. (CINCPACFLT Bill NO. R0007089SF00016). CINCPACFLT did not bill Paramount Pictures for the labor hours NAVINFO West personnel devoted to the production, nor for the work performed by Navy personnel from the various Comptroller and Public Affairs Offices involved in *The Hunt for Red October* production.

2. Principal Photography

All of the charges assessed to Paramount Pictures for DoD assistance in the production were incurred during this principal phase. Principal photography involving the United States Navy began on April 18, 1989 at Port Angeles, WA, in the Puget Sound area. This photography involved USS HOUSTON (SSN-713), USS REUBEN JAMES

(FFG-57) with embarked Helicopter Antisubmarine Squadron, Light Four Three (HSL-43), and a two plane detachment from Helicopter Antisubmarine Squadron, Light Two (HSL-2). The USS REUBEN JAMES was moored at the commercial terminal, with support for the helicopter squadrons provided by NAS Whidbey Island. The USS HOUSTON operated from an *ad hoc* submarine base at the United States Coast Guard Air Station, Port Angeles. (NAVINFO West, February 2, 1990, B2) In June, filming continued at the Long Beach Naval Station, where the film company embarked on four different Oliver Hazard Perry Class frigates. USS HOUSTON also provided filming support there for two days. The film crew embarked in USS ENTERPRISE (CVN 65) on the 8th and 9th of June to complete the major portion of the at-sea filming. Subsequent to reimbursement, two additional days of filming were requested and approved for 22 November and 10 December 1989. Additionally, a helicopter flight of three hours was approved for 18 December in order to acquire necessary sound effects. For this production assistance provided by the United States Navy, Paramount Pictures paid reimbursements in the amount of \$324,956.15 (NAVINFO West, February 2, 1990).

The following is an examination of the billings submitted by those DoD components that provided assistance in the production, as well as the procedures used in determining the principal charges which required reimbursement by Paramount Pictures.

**a. Commander Naval Air Force, Pacific
(COMNAVAIRPAC)**

The majority of the COMNAVAIRPAC services provided involved the use of various types of Naval aircraft. These included the SH-3H and SH-60B helicopters, the C-2A transport, the E2-C Hawkeye, and the F-14A Tomcat. COMNAVAIRPAC determined the flight hour rates for each of these aircraft based on their respective OP-20 reports. These reports provide detailed cost information by program element (e.g., manpower, material, fuel) for each type of aircraft. This enabled COMNAVAIRPAC to select those particular costs which qualified for reimbursement under CHINFO guidance. As a result, flight hour rates covered expenses for fuel, maintenance, depot level repairables, and base operating costs for such items as the ancillary equipment used in support of the aircraft. CINCPACFLT billed the Paramount Pictures Corporation \$153,953.22 for the

COMNAVAIRPAC support described in Table 4-1. (NAVINFO West, 31 Jan 1990, and CINCPACFLT Bill Number R0007089SF00016)

COMNAVAIRPAC non-flying expenses included rental charges for a van and a pickup truck used by HSL-43 and for a crane, plus required civilian overtime provided by NAS Alameda. NAVCOMPT Manual 035881, *Government-Owned Equipment Rental to Private Parties*, provides rental rates for the use of a variety of trucks, vans, and cranes found in the Navy's inventory. Whether or not these rates were applied in determining charges in this production cannot be determined due to the lack of specificity in the billing invoices with respect to the actual type and size of vehicles used.

Table 4-1

Squadron	Aircraft Requested	Flight Hours	Cost Per Hour	Total Cost
HS-2	SH-3H	87.9	856.00	75,242.40
HS-6	SH-3H	5.6	856.00	4,793.60
HS-8	SH-3H	29.9	856.00	25,594.40
HSL-43	SH-60B	13.6	885.00	12,036.00
VRC-30	C-2A	3.3	1,873.00	6,180.90
VF-213	F-14A	6.5	3,291.00	21,391.50
VAW-117	E2-C	3.8	2,107.00	8,006.60
Total Charges for Flight Hours.....				153,245.40
COMNAVAIRPAC Non-flying Expenses.....				<u>707.82</u>
TOTAL COMNAVAIRPAC Charges.....				<u><u>\$153,953.22</u></u>

**b. Commander Submarine Forces, Pacific
(COMSUBPAC)**

COMSUBPAC charged Paramount Pictures the hourly rate of \$397.00 for the use of a nuclear submarine. This reimbursement rate was derived to recoup expenses for the petroleum, oil, and lubricants consumed in daily operations. (Raaz, April 9, 1991)

Since there was no existing support facility for the USS HOUSTON at the United States Coast Guard Air Station, Port Angeles, a T-pier had to be constructed. Two forty foot camels were towed in and installed by a 30 ton floating crane brought in from Seattle (NAVINFO West, February 2, 1990, p. 8). A generator, a sewage holding tank, and a bilge tank/waste oil tank were also installed. The Bangor, WA Submarine Base submitted charges of \$3,400.00 for the delivery and retrieval of these camels and \$737.00 for the transportation and overtime expenses of the civilian employees. COMSUBPAC charges also included \$1,481 for a Torpedo Retriever, which covered expenses for diesel fuel and lube oil consumed.

**c. Commander Naval Surface Force Pacific
(COMNAVSURFPAC)**

CINCPACFLT billed Paramount Pictures \$80,280.70 for the use of four Oliver Hazard Perry Class frigates (FFG's). The

Comptroller derived this charge by assessing Paramount the hourly rate of \$1,102.00 for the 72.85 hours of FFG service provided. How this rate was developed or what expenses it actually covered could not be explained by staff at the CINCPACFLT Comptroller Office, NAVINFO West, the COMNAVSURFPAC Comptroller Office, CHINFO, the COMNAVSURFPAC Public Affairs Office, or the individual FFG Commands.

Paramount Pictures reimbursed COMNAVSURFPAC \$80,370.70, which included the charges described above and \$90.00 for the loss of one folding table. (CINCPACFLT Bill Number R0007090SF00001, Bill Number R0007089SF00016, and NAVINFO West, 31 JAN 1990)

d. Naval Station Long Beach, California

Naval Station Long Beach provided 51.5 hours of yard oiler (YO) and yard tugboat service (YTB, large harbor tugboat) in support of the production (NAVINFO West, February 2, 1990, 2B.2). The same hourly rate of \$225.00 was applied to both the YO and YTB, which are different with regards to size, engine type, and fuel consumption rate (Janes Fighting Ships, 1989). Paramount Pictures

was charged \$4,500.00 for 20 hours of YO service, \$7,087.50 for 31.5 hours of YTB service, and an additional \$1,498.37 for miscellaneous expenses that included civilian tugboat pilot overtime, crane usage, and paint.

e. Naval Shipyard - Puget Sound, Washington

To assist in the production, the Puget Sound Naval Shipyard provided a yard tugboat (YTB-767) for submarine support at Port Angeles. CINCPACFLT required a reimbursement of \$1,626.90 for the 22 hours of tugboat service provided, as well as an additional \$2,187.50 for a commercial stand-by tugboat. The commercial tug was required until the Navy tugboat was no longer needed in the production. Staff at the Puget Sound Naval Shipyard Comptroller Office were unable to provide details as to how these charges were derived, or what DoD expenses they covered (Telephone conversations with personnel from Puget Sound Comptroller Office, April 8, 1991). The \$73.95 YTB hourly rate used ($\$1,626.90/22 \text{ hrs}$) does not equate to the \$225.00 hourly rate used for YTB services provided by the Long Beach Naval Station. NAVINFO West stated that the rates differed because the individual commands established

their own hourly rates to recover the expenses of the civilian tugboats required to replace the Navy tugboats used in the production.

The Puget Sound Naval Shipyard also provided services which were not listed on the original CINCPACFLT billings. Prior to receiving these services, Paramount Pictures established a Special Deposit in the amount of \$3,000 with the Puget Sound Naval Shipyard. This Special Deposit served the same function as the Letter of Credit already issued by Paramount. The Puget Sound Naval Shipyard charged \$945.23 against the Special Deposit for services described on the billing invoice as "Provide props for movie" (Puget Sound Naval Shipyard Invoice Order No. 80900). This billing included a surcharge of 15 percent for the assistance provided. Paramount Pictures received a refund for the remaining balance of \$2,054.77 upon completion of filming in the Puget Sound area. Explanations for the necessity of this Special Deposit or for the 15 percent surcharge were unattainable due, in large part, to reassignment of the comptroller personnel responsible for generating the original invoices. (Telephone conversations with personnel from Puget Sound Comptroller Office, April 8, 1991)

f. Naval Undersea Warfare Engineering Station

In support of USS HOUSTON and USS REUBEN JAMES during filming off Port Angeles, the Naval Undersea Warfare Engineering Station at Keyport, WA provided a yard tugboat and crew (YTB-836). Paramount paid per diem and billiting costs for the tugboat crew, and was assessed an hourly rate of \$52.50 for the 28.5 hours of tugboat service. This YTB hourly rate differs from the YTB rates used by other DoD components. Although Paramount Pictures reimbursed the Navy for the total costs of \$1,496.24, the Budget Officer of the Naval Undersea Warfare Engineering Station stated that the Station itself was never reimbursed. (Telephone conversation with Budget officer, April 10, 1991).

**g. Commander Special Boat Squadron One
(COMSPECBOATRON)**

In support of the production, Patrol boats 737 and 755 from COMSPECBOATRON ONE conducted two round trip runs from San Diego to Long Beach. The Paramount Pictures Corporation was charged \$2,137.20 for the 3,288 gallons of fuel consumed. (CINCPACFLT Bill Number R0007090SF00001)

**h. Commander Naval Submarine Training Facility
(COMSUBTRAFAC)**

The charge of \$28.20 consisted of items requested by NAVINFO West in support of the production. This included items such as range rate slide rules and a maneuvering board tablet, which were all billed at their unit cost.

i. Administrative Surcharge

CINCPACFLT assessed Paramount Pictures an administrative surcharge of \$9,472.28 based on guidance from the July 29, 1985 DODINST 7230.7 entitled *User Charges* (CINCPACFLT Bill Numbers R0007090SF00001, R0007089SF00016, and NAVINFO West, 31 Jan 1990). Paragraph F.2a(6) of DODINST 7230.7 stipulates that an administrative surcharge of three percent of total costs may be assessed in order "to cover general and administrative cost of the DoD Component". This same instruction also states that cost computations may include charges for depreciation and the full costs of civilian and military personnel services (paragraphs F.2a(1,2, and 4). In billing for DoD assistance provided in *The Hunt for Red October* production, CINCPACFLT was not required under DODINST 7230.7 to

seek reimbursement for these types of costs since the Instruction also states that "(t)he provisions of this Instruction do not apply when other statutes or directives require different practices or procedures...." DODINST 5410.15 is listed in the instruction as one of these "other directives".

Neither DODINST 5410.15 nor DODINST 5410.16 specifically mentions the use of administrative surcharges, although paragraph 4b(13) of DODINST 5410.16 stipulates that, "(b)eyond actual operational expenses, no charges shall be levied for asset usage (i.e., rental and/or depreciation factors)."

j. Military and Civilian Personnel Costs

Of the total expenses charged to Paramount Pictures, less than \$500 or 0.15 percent involved reimbursement for labor costs. As mentioned earlier, DODINST 5410.16 requires reimbursement for civilian overtime expenses only (DODINST 5410.16, January 26, 1988, para 4(b)11). With regard to military personnel appearing in the film, DODINST 5410.16, paragraph C9 stipulates:

Military personnel in an off-duty, nonofficial status may be hired by the production company to perform as actors, extras, etc., provided there is no conflict with any existing Service regulation.

At sea, military film extras were used from all units in which the Paramount film crew embarked and, in keeping with DODINST 5410.16, these extras were not paid. In port, CHINFO required military personnel appearing in the film to be in a leave or liberty status (CHINFO, 071429Z APR 89). Eleven Navy personnel, nine enlisted and two officers, were hired for scenes filmed at the Paramount studio. (NAVINFO West, February 2, 1990, p. 5)

3. Post-Production

CHINFO assigned a Lieutenant Commander (O-4) to oversee post-production operations, which primarily involved dealing with the large number of requests for premieres, charity screenings and special screenings received from around the world. (NAVINFO West, February 2, 1990, p. 6). Again, the Navy did not require reimbursement for such services in accordance with DODINST 5410.16.

D. SUMMARY

The United States Navy submitted billing after primary photography was completed on July 20, 1989. Three separate bills were submitted by CINCPACFLT to the Paramount Pictures Corpor-

ation, with additional charges required for support provided in November and December. The total reimbursement made by the Paramount Pictures Corporation was in the amount of \$325,215.11 (NAVINFO WEST, February 2, 1990).

Production companies have traditionally made donations to the Morale, Welfare, and Recreation accounts of those commands involved in the production. Upon completion of *The Hunt for Red October* production, the producers provided a donation of \$22,500 to fourteen DoD components. (DeWaay, December 19, 1989).

Table 4-2 provides a summary of the total expenses CINCPACFLT billed Paramount Pictures for the assistance provided by the various DoD Components participating in the production (CINCPACFLT Bill Number R0007090SF00001 and Bill Number R0007089SF00016).

In order to gain a better understanding of DoD policy regarding assistance to private parties, the next chapter examines the cost reimbursement policies followed in providing assistance to a private party outside the entertainment industry. In particular, the chapter provides an examination of the Navy's involvement in the cleanup operations of the Exxon Valdez oil spill.

Table 4-2

A. COMNAVAIRPAC.....	153,953.22
B. COMSUBPAC	
USS HOUSTON (SSN-713).....	49,228.00
USS LOUISVILLE (SSN-724).....	5,558.00
Torpedo Retriever.....	1,481.00
Bangor, WA.....	<u>4,137.00</u>
Subtotal.....	60,404.00
C. COMNAVSURFPAC	
USS WADSWORTH (FFG-9).....	13,058.70
USS GEORGE PHILIP (FFG-12)...	10,008.00
USS GARY (FFG-51).....	26,448.00
USS REUBEN JAMES (FFG-57)...	<u>30,856.00</u>
Subtotal.....	80,370.70
D. NAVAL STATION - Long Beach, CA	
Yard Oiler.....	4,500.00
Yard Tugboat.....	7,087.50
Miscellaneous Charges.....	<u>1,498.37</u>
Subtotal.....	13,085.87
E. Naval Shipyard - Puget Sound, WA.....	3,814.40
F. Naval Undersea Warfare Station.....	1,496.24
G. COMSPECBOATRON ONE	
Patrol Boat 737 and 755.....	2,137.20
H. COMSUBTRAFAC.....	<u>28.20</u>
Total	315,742.83
I. 3 Percent Administrative Surcharge.....	<u>9,472.28</u>
TOTAL BILLING.....	<u><u>\$325,215.11</u></u>

V. DOD SUPPORT OF THE EXXON VALDEZ OIL SPILL CLEANUP OPERATION

A. INTRODUCTION

This chapter examines the cost reimbursement policies and billing procedures followed in determining the costs to assess the Exxon Corporation for federal assistance provided in the *Exxon Valdez* oil spill cleanup operation. Offered first is a brief explanation of federal government involvement in this cleanup, as well as the policies governing reimbursement for this type of assistance provided to private parties. This is followed by an examination of the major costs incurred by the DoD and, in particular, the methods used to determine cost reimbursements for the assistance provided by United States Navy.

B. BACKGROUND

On March 24, 1989, the oil tanker *Exxon Valdez* ran aground on Bligh Reef, spilling over 10 million gallons of crude oil into Prince William Sound, Alaska (GAO, October 30, 1989). This spill, the

largest in U.S. history, required an extensive cleanup operation in which the Exxon Corporation spent almost two billion dollars as of January, 1991 (GAO Draft Report, March 1991). At the time of the *Exxon Valdez* spill, the Clean Water Act was the principal policy guidance governing federal response to major oil spills. In particular, this Act addresses those oil spill cleanups in cases which require resources beyond the capabilities of the spiller or in situations where the spiller is unknown or unwilling to take responsibility for the spill. This Act holds the spiller liable for the costs of oil removal up to \$150 per gross ton of oil tanker. Although the gross tonnage of the *Exxon Valdez* oil tanker was roughly 95,000 tons, making Exxon's liability \$14.3 million, Exxon assumed financial responsibility for the entire cleanup operation (GAO Draft Report, March 1991, p. 14). The Clean Water Act does stipulate that there is no limitation as to the spiller's liability if willful negligence or misconduct is proven.

The Clean Water Act provides for a National Contingency Plan, developed by the President, "to provide efficient, coordinated, and effective action for minimizing damage from oil spills..." (GAO,

October 30, 1989, p. 12). The first National Contingency Plan was adopted in 1968 and the current plan is found in chapter 40, part 300 of the Code of Federal Regulations (CFR) (GAO, October 30, 1989, p. 13). Although the plan establishes separate roles for twelve federal agencies in response to an oil spill, only ten actually participated in the Exxon Valdez oil spill cleanup operation (GAO Draft Report, March 1991, p. 49). These were the Departments of Defense, Labor, the Interior, Agriculture, Justice, Commerce, Energy, Transportation, Health and Human Services, and the Environmental Protection Agency (GAO, October 30, 1989, p. 12). The State Department and the Federal Emergency Management Agency are the two agencies designated in the plan that were not involved in the *Exxon Valdez* operation. The ten federal agencies contributed to the cleanup effort by monitoring and supporting the operation, removing oil from the water and beaches, dealing with dead and injured wildlife, and assessing damage to the environment. (GAO, January 26, 1990, p. 2) As of June 30, 1990, these agencies had incurred and subsequently reported spill related costs totaling \$152.9 million. The Exxon Corporation reimbursed the Government for \$114.9 million as of

September 30, 1990, with an additional \$7.5 million in the process of transfer. Recovery of the remaining \$30.5 million of reported costs is uncertain for reasons that are discussed later. (GAO Draft Report, March 1991, p. 25)

The following section describes the policies in effect at the time of the spill, and the cost accounting procedures used by the Government for collecting reimbursements from the Exxon Corporation for the assistance provided in the cleanup operation.

C. GOVERNMENT BILLING AND REIMBURSEMENT POLICIES FOLLOWED DURING THE CLEANUP OPERATION

Nine of the ten federal agencies involved sought full or partial reimbursement for the services provided in support of the *Exxon Valdez* oil spill cleanup; the Department of Energy did not track and bill for costs incurred. The agencies that sought reimbursement used two approaches: the 311(k) fund and Direct Agreement. (GAO, January 26, 1990, p. 18)

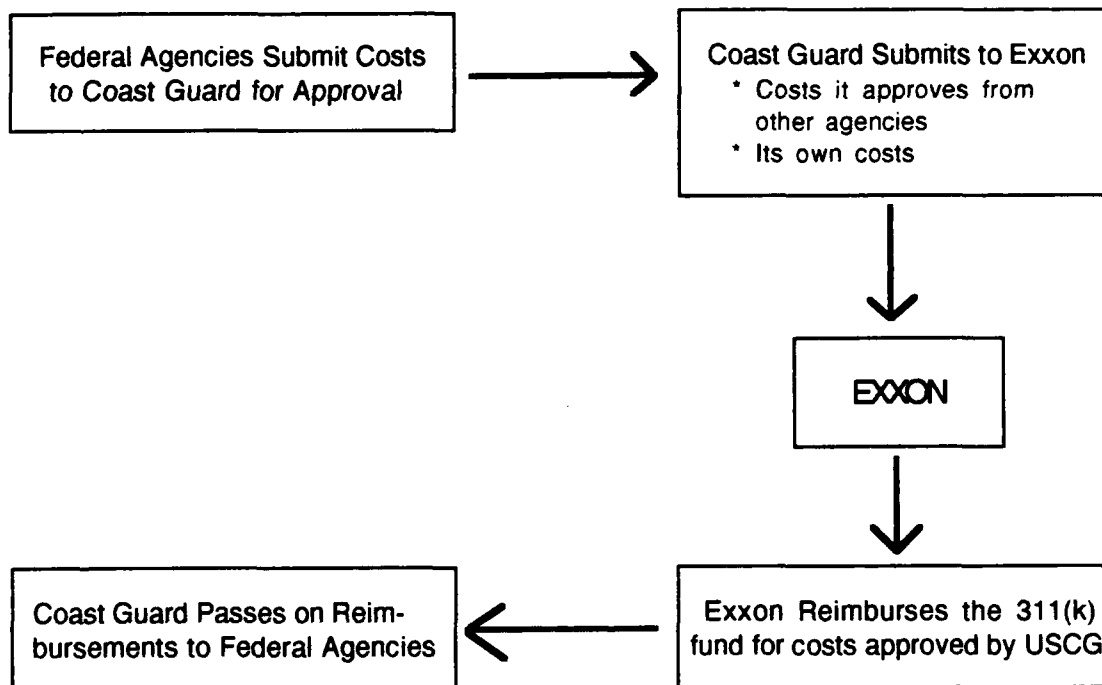
1. Reimbursement Under 311(K) of The Clean Water Act

The Clean Water Act provides guidance for federal assistance in the cleanup of oil spills, and designates the United

States Coast Guard, under the Department of Transportation, as the agent responsible for the day-to-day coordination of federal cleanup activities (GAO Draft Report, March 1991, p. 11). Subsection 311(k) of the Clean Water Act authorizes the use of a revolving fund for oil removal activities in which the federal government has assumed charge of the cleanup operation. This revolving fund is funded mainly through appropriations, with the spiller reimbursing the federal government for those costs incurred in the actual cleanup of oil from the water and shorelines. The fund is not used for damage assessment costs or restoration costs. Although Exxon took charge of the cleanup operation in the *Exxon Valdez* spill, the Coast Guard began using the 311(k) fund because of the magnitude of the spill and the substantial federal involvement required (GAO, January 26, 1990, p. 19). As mandated in the act, the Coast Guard required all agencies (1) to seek advance authorization of their spill related activities from the Coast Guard on-scene coordinator and (2) to submit the costs of these activities to the Coast Guard for approval and referral to Exxon for reimbursement. Exxon would then reimburse the 311(k) fund through the Coast Guard which, in turn,

would reimburse each federal agency for the costs incurred. Seven of the ten agencies involved in the cleanup sought reimbursement under this process, and this included the Department of Defense. Figure 5-1 presents a diagram of this flow of funds. (GAO, January 26, 1990, pp. 218-20)

Figure 5-1



2. Reimbursement Through Direct Agreement

Three of the nine federal agencies providing services sought reimbursement through direct agreements with Exxon. Two of the

three agencies were also using the 311(K) process for costs not covered under these direct agreements. The agreements mainly involved recoupment of damage assessment costs incurred by the State of Alaska and the Departments of Agriculture, Commerce, and the Interior. This method of reimbursement was not employed by the Department of Defense. (GAO, January 26, 1990, p. 18)

With respect to reimbursements, the GAO report points out that there was confusion among the agencies involved regarding the reimbursement process to be followed during the *Exxon Valdez* oil spill cleanup operation. Several agencies, including the Departments of the Interior and Commerce, assumed that "the criteria for using the 311(k) fund had not been met in that the Coast Guard had neither requested their services nor assumed control for managing the cleanup from Exxon" (GAO Draft Report, March 1991, p. 50). They assumed that they would have to fund their own cleanup activities, as stipulated under the National Contingency Plan. The GAO report stated that four federal agencies, including DoD, were not informed until May 12, 1989, six weeks after the spill occurred, that the 311(k) fund would actually be used. (GAO Draft Report, March 1991,

p. 51) In addition, the Coast Guard did not provide the "specificity needed" and "agencies did not apply consistent methods, criteria, and standards to determine billed charges". The GAO found examples of both under- and over- billing of costs "...perhaps exceeding, in total, \$5 million dollars". (GAO Draft Report, March 1991, p. 53)

Although DoD was not affected, the GAO also concluded that several federal agencies had not received reimbursements for some of their costs because "Coast Guard interpretations limited reimbursements from the pollution fund" (GAO Draft Report, March 1991, p. 4). The Clean Water Act specifies that agencies can obtain reimbursement from the 311(k) fund for "oil removal activities", and regulations stipulate that the on-scene coordinator is responsible for determining which activities fall under that definition (GAO, Draft Report, March 1991, p. 40). The GAO report stated that the act defines oil removal as

removal of oil...from the water and shorelines or the taking of such actions as may be necessary to minimize or mitigate damage to the public health or welfare, including, but not limited to, fish, shellfish, wildlife, and public and private property, shorelines, and beaches (GAO Draft Report, March 1991, p. 40).

According to the GAO, the on-scene coordinator has "considerable latitude" in determining what is an oil removal activity and, in the *Exxon Valdez* case, some agency activities were not reimbursed because the on-scene coordinator did not believe the activities were oil removal functions. The Chief of the Marine Environmental Safety Division in Coast Guard headquarters told the GAO that "...the coordinator is expected to make decisions based on his/her judgement... and that coordinators' decisions will differ from one spill to another" (GAO Draft Report, March 1991, p. 42). The Coast Guard typically tries to minimize cost reimbursements for two reasons: (1) to encourage the spiller to maintain management control of the cleanup operation and to provide all the necessary resources and (2) to avoid possible depletion of the 311(k) fund (GAO Draft Report, March 1991, p. 43).

Although the 311(k) fund is authorized at \$35 million, the balance at the time of the Valdez spill was only \$6.7 million which, according to the GAO, was "enough to finance less than one week of response operations" (GAO, October 30, 1989, p. 18). The GAO report stated that the Coast Guard on-scene coordinator did not authorize

several agency activities even though reimbursement could have been allowed under the regulatory definition of oil removal (GAO, Draft Report, March 1991, p. 4). An example provided in the GAO report involved the Occupational Safety and Health Administration (OSHA), under the Department of Labor. OSHA incurred costs in 1989 of \$191,000 to ensure that worker safety regulations were being implemented and to prevent hazards to worker health and safety. OSHA officials stated that the cost incurred, by bringing in twenty additional personnel to oversee the cleanup operation fell within "defensive actions...to prevent, minimize, or mitigate the threat to public health..." as described in the National Contingency Plan. (GAO, Draft Report, March 1991, p. 44). The GAO report stated that the on-scene coordinator did not believe OSHA's activities were oil removal related and, therefore, did not qualify for reimbursement through the 311(k) fund. (GAO Draft Report, March 1991, p. 44)

The GAO report stated that the Coast Guard was not consistent in its authorizations, as substantiated by an example similar to OSHA's, involving the Federal Aviation Administration (FAA). The FAA found it necessary to increase its staff in order to

establish temporary air traffic control operations in the area during the cleanup operation. In this case, the GAO points out that, although the FAA was not involved directly in any cleanup activity, the Coast Guard on-scene coordinator determined that this "...involvement was necessary to facilitate the cleanup efforts" (GAO Draft Report, March 1991, p. 44). Unlike OSHA, the FAA was reimbursed for the costs incurred in providing this support. (GAO, January 26, 1990, p. 23)

Federal agencies, including DoD, had to absorb the costs into their normal operations and/or reprogram existing funds to pay for the expenses of spill related activities not reimbursed by Exxon or by the Coast Guard. Some agencies did receive additional funding from the Congress, but this did not include the Department of Defense. (GAO Draft Report, March 1991, p. 28)

The next section describes the costs incurred, and reported by, the Government for the assistance provided in support of the cleanup operation.

D. GOVERNMENT COSTS INCURRED AND REPORTED IN SUPPORT OF THE CLEANUP EFFORT

Table 5-1 summarizes the \$152.9 million in costs reported by the nine federal agencies as of June 30, 1990. These were the costs reported to the GAO, not all of which were billed to Exxon for reasons that are discussed later (GAO Draft Report, March 1991, p. 22). As depicted in the table, spill related costs totaled \$152.9 million, which included \$116.1 million for removal, \$22.6 million for damage assessment, and \$14.2 million for other costs, such as monitoring worker safety and preparation of possible litigation. Four agencies--the Departments of Defense, Transportation, the Interior, and Commerce--accounted for 87 percent of the total costs. DoD reported the highest costs--\$62.2 million. (GAO Draft Report, March 1991, p. 21)

According to a report from the Secretary of Defense's Office of the Deputy Comptroller (ODC), Exxon has reimbursed the Government for the entire amount of costs incurred by the United States Navy. However, the Navy has actually received only \$17.1 million in reimbursements; the remaining \$25.4 million has been retained by the Coast Guard in the 311(k) fund. (Office of the Deputy Comptroller, OSD, December 11, 1990)

Table 5-1

FEDERAL AGENCY COSTS (IN MILLIONS) REPORTED
THROUGH JUNE 30, 1990

<u>Agency</u>	<u>Removal</u>	<u>Damage Assessment</u>	<u>Other</u>	<u>Total</u>
Department of Defense	62.2	0.0	0.0	62.2
Department of Transportation	38.9	0.0	0.0	38.9
Department of the Interior	5.4	7.1	4.6	17.1
Department of Commerce	4.9	9.5	0.4	14.8
Environmental Protection Agency	0.5	0.9	6.1	7.5
Department of Agriculture	2.1	5.1	0.0	7.2
Department of Justice	0.0	0.0	2.6	2.6
Department of Health and Human Services	2.1	0.0	0.3	2.4
Department of Labor	<u>0.0</u>	<u>0.0</u>	<u>0.2</u>	<u>0.2</u>
TOTAL	116.1	22.6	14.2	152.9

The costs reimbursements made by Exxon for federal assistance provided in the *Exxon Valdez* oil spill cleanup operation are discussed in the next section.

E. COST REIMBURSEMENTS MADE BY EXXON

As of September 30, 1990, the Exxon Corporation had reimbursed the Government for \$114.9 million of the \$152.9 million in costs reported by the nine federal agencies. This included reimbursements made to the 311(k) pollution fund and through direct agreements. Table 5-2 provides a breakdown of these reimbursements. (GAO Draft Report, March 1991, p. 25)

The GAO concluded that the recovery of \$30.5 million in costs incurred was "uncertain or unlikely" for three reasons:

1. The Coast Guard or Exxon is questioning the reasonableness or need for a particular service.
2. Exxon has not paid reimbursements for particular services which the agencies are now pursuing through litigation.
3. Some agencies do not plan to bill Exxon for particular costs.

Table 5-2

COSTS REIMBURSEMENTS (IN MILLIONS) MADE BY EXXON

<u>Agency</u>	<u>Total reported Cost</u>	<u>Amount paid by Exxon</u>	<u>Amount being processed</u>	<u>Amount that may not be reimburse</u>
Department of Defense	62.2	56.3	0.0	5.9
Department of Transportation	38.9	36.1	2.8	0.0
Department of Interior	17.1	7.2	1.0	8.9
Department of Commerce	14.8	7.3	1.6	5.9
Environmental Protection Agency	7.5	7.1	0.0	4.4
Department of Agriculture	7.2	4.9	0.0	2.3
Department of Justice	2.6	0.0	0.0	2.6
Department of Health and Human Services	2.4	0.0	2.1	0.3
Department of Labor	<u>0.2</u>	<u>0.0</u>	<u>0.0</u>	<u>0.2</u>
TOTAL	152.9	114.9	7.5	30.5

Of the \$30.5 million in cost recoveries that are uncertain, \$5.9 million relates to costs incurred by the Department of Defense. In particular, Exxon is evaluating the rates used for determining the costs of two oil removing dredges provided by the Army Corps of Engineers. (GAO Draft Report, March 1991, pp. 25-26)

Examples of some other unlikely recoveries include \$2.6 million incurred by the Department of Justice to prepare possible litigation against Exxon, \$0.3 million incurred by the Department of Health and Human Services for health services provided to Native Americans affected by the spill, and \$2.3 million incurred by the Forest Service in performing damage assessment studies (GAO Draft Report, March 1991, p. 27).

F. AGENCIES REIMBURSED BY COAST GUARD FOR LESS THAN THE RECOVERIES RECEIVED FROM EXXON

Several agencies, including the Department of Defense, objected to not receiving full reimbursement from the 311(k) fund for the costs incurred in the cleanup operation. Of the total \$100.9 million paid by Exxon into the pollution fund, \$38.1 million, or 37.8 percent, was retained by the Coast Guard. (Office of Deputy Comptroller, OSD, December 11, 1990)

Exxon is required, under the Clean Water Act, to reimburse the Government up to the liability limit for the actual costs incurred in the cleanup operation. However, the Act does not require the Coast Guard to reimburse the individual agencies for the full amount received from Exxon. The Coast Guard did not reimburse DoD, or any of the other agencies, for what it defined as the "non-incremental costs" paid by Exxon (Haas, 19 JUN 90). The Coast Guard expressed that such costs should not be reimbursed between federal agencies but should, instead, remain in the pollution fund where it would be available for future oil spills (GAO Draft Report, March 1991, p. 31). The matter was forwarded to the General Accounting Office for resolution (Haas, 19 JUN 90). The March 1991 GAO report stated

The regulations, established pursuant to the act, limit agency reimbursements from the 311(k) fund to 'reasonable amounts not ordinarily funded by an agency's regular appropriations and that are not incurred during normal operations'. (GAO Draft Report, March 1991, p. 30)

The GAO report expressed that the regulations' definition of reimbursable or incremental costs included

...those costs expended specifically on the response effort, such as travel, overtime for civilian personnel, equipment rentals, costs to operate vehicles, vessels, and aircraft, and supplies and equipment used in the response effort (GAO Draft Report, March 1991, p. 30).

GAO staff agreed with the Coast Guard that reimbursable costs did not include base salaries of agency personnel, or asset use charges for government owned equipment (GAO Draft Report, March 1991, p. 31). As a result of these interpretations, the Coast Guard reimbursed the federal agencies involved in the cleanup for only 62 percent of the costs incurred. The Department of Defense received only \$23.6 million in reimbursements, less than 42 percent of the total costs actually incurred. The remaining \$32.7 million was retained by the Coast Guard in the 311(k) fund. Table 5-3 provides a breakdown of the reimbursements made through the 311 (k) fund and identifies those federal agencies receiving reimbursements for less than the costs submitted to the Coast Guard. (GAO Draft Report, March 1991, p. 32)

G. DOD BILLING PROCEDURES FOLLOWED AND THE COSTS INCURRED IN SUPPORT OF THE CLEANUP EFFORT

DoD tasked the Commander, Joint Task Force, Elmendorf, Alaska (JTF-AK) to ensure that billings for DoD support were processed in a timely manner and with adequate documentation (JTF-AK, Naval Message, 271700Z APR 89). The Commander, JTF-AK, established DoD

Table 5-3

REIMBURSEMENTS MADE THROUGH THE 311(K) FUND (IN MILLIONS)

<u>Agency</u>	<u>Amounts paid by Exxon</u>	<u>Amounts CG paid to agency</u>	<u>Amounts retained in 311(k) fund</u>	<u>Percen paid to agency</u>
Department of Transportation	36.2	34.9	1.3	96
Department of Commerce	4.0	3.2	0.8	80
Department of Defense	56.3	23.6	32.7	42
Department of Interior	<u>4.4</u>	<u>1.1</u>	<u>3.3</u>	<u>25</u>
Total	100.9	62.8	38.1	62

expense collection and reporting procedures in an APR 89 priority message, which directed all DoD activities involved in the cleanup operation

...to assure that the total cost for all actions taken in support of the Alaska oil spill cleanup are documented in a manner which will facilitate accurate billing and validation by followup audit. This includes maintaining logs, as needed, to capture both full and incremental cost. We anticipate that a majority of DoD expenses will be reimbursed through the pollution fund...(JTF-AK, Naval Message, 271700Z, APR89)

As the message indicates, DoD expected the 311(k) fund to be used to provide restitution, even though the Coast Guard did not officially inform DoD of such an intention until the following month. The message also provided explanations of reimbursable costs as defined in the Clean Water Act and stated that reimbursable costs would include those which the Coast Guard

...found to be reasonable and as a result of removal activity and that are not ordinarily funded by an agency's regular appropriations and that are not incurred during normal operations. (JTF-AK, Naval Message, 271700Z, APR89, p. 3)

As instructed by the CNO , JTF-AK directed all commands involved to submit bi-weekly summary reports, with the reporting period ending on the Friday of the second week (CNO, Administrative Message, 121815Z MAY 89). Commands were required to report in a format that broke down costs by line item, to describe the total dollars by specific appropriation, and to show the basis for calculating the cost (e.g., travel order, purchase order, standard cost manual). When cost factors were used, JTF-AK directed that commands provide input at non-DoD and DoD rates. (JTF-AK, Naval Message, 271700Z, APR 89, p. 3) An example provided in the guidance dealt with aircraft support.

Cost--\$25,000. Five hours flown mission 45XYZ at a cost of \$5,000/hour. Cost Basis: Air Force Regulation (AFR) XXX-Y, table KK, non-DoD rate. Cost would be XX,XXX if charged at DoD rate. (JTF-AK, Naval Message, 271700Z, APR 89, p. 4)

After the commands submitted their reports on expenditures, the JTF-AK command would consolidate and coordinate the reported DoD costs with the Coast Guard's on-scene coordinator for reimbursement purposes. The JTF-AK would then advise the DoD activities on billing procedures for services that had been approved as charges to the 311(k) fund. (JTF-AK, Naval Message, 271700Z, APR 89, p. 3) Following this direction, the DoD commands which participated in the cleanup operation reported costs totalling \$62.2 million. Table 5-4 provides a breakdown, by Service, of the DoD costs reported as of June 30, 1990. (Telephone Conversation with ODC, Management Systems, December 11, 1990 report).

Of the three Departments within the DoD that provided assistance (Army, Navy, and Air Force), the United States Navy submitted billings for \$42.5 million or 68 percent of the total costs incurred by DoD. The Navy provided barrack ships which were used to house cleanup crews and to support cleanup activities on nearby beaches. The Navy also provided oil skimmers, booms, tow boats,

Table 5-4

DOD COSTS INCURRED (IN MILLIONS) IN CLEANUP OPERATION

	Total Costs Billed by DoD	Total Paid by Exxon	Amounts Unpaid by Exxon	Amounts Retained by Coast Guard	Amounts Paid to DoD	Unpaid DoD Costs
ARMY						
Dredges (Corp of Engineers)	10.4	4.5	5.9	0.0	4.5	5.9
Aeromedical Evacuation	1.4	1.4	0.0	0.0	1.4	0.0
Oil Spotting	1.2	1.2	0.0	0.0	1.2	0.0
Crisis Center	0.4	0.4	0.0	0.4	0.0	0.4
ARMY TOTAL	13.4	7.5	5.9	0.4	7.1	6.3
NAVY						
Skimmers-Operations	7.7	7.7	0.0	0.0	7.7	0.0
Skimmer-Rentals	10.1	10.1	0.0	7.0	3.1	7.0
Barracks Ships	24.0	24.0	0.0	18.4	5.6	18.4
Mechanized Landing Craft	0.7	0.7	0.0	0.0	0.7	0.0
NAVY TOTAL	42.5	42.5	0.0	25.4	17.1	25.4
AIR FORCE						
MAC Flights	3.7	3.7	0.0	0.0	3.7	0.0
Decontamination Units	0.9	0.9	0.0	0.0	0.9	0.0
Crisis Center Ops	1.7	1.7	0.0	0.9	0.8	0.9
AIR FORCE TOTAL	6.3	6.3	0.0	0.9	5.4	0.9
DoD TOTAL	62.2	56.3	5.9	26.7	29.6	32.6

other equipment, and personnel necessary to support the removal of oil from the water and shorelines. The Navy billings also included charges for costs incurred by the United States Marine Corp in

providing flight services. These charges are discussed in detail in Section H(3).

As shown in Table 5-4, the Navy received the lowest percentage of reimbursements among the Departments, recouping only 40 percent of the costs incurred in providing support. This reimbursement deficiency resulted from disagreements with the Coast Guard over what constituted reimbursable costs and not from Exxon's failure to make payments to the 311(k) fund. (Mizuo, telephone conversation, January 24, 1991)

The next section reviews some of the procedures followed by the Navy in determining the costs to bill Exxon for services provided.

H. REVIEW OF UNITED STATES NAVY SUPPORT FOR THE EXXON VALDEZ OIL SPILL CLEANUP OPERATION

In accordance with CNO guidance, based on NAVCOMPT Manual, Volume 3, paragraph 035875, billings to the Coast Guard totalled \$42.5 million (CNO Naval Message, 121815Z MAY 89 and CINCPACFLT Naval Message, 240131Z FEB 90). For purposes of comparison and review, the charges for the Navy assistance provided during the cleanup effort are organized into categories which are different

from the four presented in the table. These are, (1) skimmer rental costs, (2) amphibious ships barracks costs, (3) flight operations costs, and (4) mechanized landing crafts lease. The cost accounting and billing procedures followed for each of these is examined in the following subsections.

1. Skimmers Rental and Accessory Equipment Costs

The Navy provided MARCO Class V and Class XI Oil Skimmers and MONARK 24' tow boats to assist in the removal of oil from the water and shorelines (GAO, January 26, 1990, p. 11). Skimmer rental rates were charged at commercial rental rates but capped at the acquisition costs (DoD Comptroller Invoice Number 89-97-015). During the billing process, Exxon expressed dissatisfaction with the rental rates charged by the Navy. In order to resolve the issue, the Navy agreed to search the private sector for commercially comparable equipment and to gather rental and lease cost data for comparison with Navy rates. (Office of the Comptroller, Department of the Navy, November 8, 1989) Based on the study, the rental rates issue was resolved, with Exxon reimbursing the Coast Guard \$10,057,972. This was the full amount submitted by CINCPACFLT in billings to the Coast Guard. (Haas, 19 JUN 1990).

Although Exxon reimbursed the Coast Guard for the entire amount as of December 11, 1990, the Navy received only \$3.1 million. The Coast Guard retained the remaining \$7.0 million in the 311(k) fund. (Office of Deputy Comptroller, OSD, December 11, 1990)

2. Amphibious Ships Barracks

The Navy provided two LSD's (Landing Ship Docks) and four LPD's (Landing Platform Docks), which housed cleanup crews and supported cleanup activities on nearby beaches. These ships included USS OGDEN (LPD 5), USS DULUTH (LPD 6), USS CLEVELAND (LPD 7), USS JUNEAU (LPD 10), USS MT VERNON (LSD 39), and USS FT MCHENRY (LSD 43). (CINCPACFLT Comptroller, File RATE_REV.WK1)

In providing cost reporting guidance to COMNAVSURFPAC, CINCPACFLT divided the costs involved in providing ship's support into five categories: (1) Military Personnel Costs (2) Maintenance Costs-Emergent Repair, Intermediate Repair (IMA), and Phased Maintenance Availability (PMA), (3) Steaming Costs, (4) Other Costs, and (5) Exxon Support. (CINCPACFLT, Naval Message, 142246Z, JUL 89)

a. Military Personnel Costs

Military personnel costs for both officers and enlisted were computed by CINCPACFLT based on (1) the number of days on scene and in transit reported by COMNAVSURFPAC, (2) number of personnel on board ship, and (3) rates from the Composite Standard Military Rate (CSMR) in NAVCOMPT Note 7041 dated 8 December 1988 (Mizuo, April 29, 1991). CINCPACFLT submitted billings to the Coast Guard for \$2,308,080 for Navy Officer Personnel expenses, and \$14,818,795 for Navy enlisted personnel expenses, for a total of \$17,126,875 (CINCPACFLT, Naval Message, 240131Z FEB 90). As directed in the NAVCOMPT Manual, paragraph 035750, acceleration factors were applied to the CSMR provided in NAVCOMPT Note 7041. This included a 14 percent "leave and holiday accrual" for both officers and enlisted, as well as an "other personnel support costs accrual" of 6 percent for officers and 18 percent for enlisted (CINCPACFLT, File Name MPN_REV3, 17 AUG 89).

b. Emergent Repair, Intermediate Repair, and PMA

CINCPACFLT used daily rates developed by NAVCOMPT (NCB-1) for each of these Ship's maintenance expenses. An asset use

rate was also employed. Table 5-5 describes the various rates used for the six ships providing assistance. (Mizuo, April 29, 1991) CINCPACFLT calculated maintenance and asset use costs by multiplying maintenance and asset use rates by the number of *on scene days* reported by COMNAVSURFPAC. These rates were not applied to days required in transiting to and from the scene.

Table 5-5

SCHEDULE OF DAILY SHIP MAINTENANCE AND ASSET USE RATES

Ship	Emergent Repair	IMA	PMA	Asset Use Charge
USS JUNEAU	2,312	948	9,600	2,516
USS FT MC HENRY	1,877	1,003	9,600	22,629
USS CLEVELAND	2,660	1,123	9,600	2,291
USS MT VERNON	1,877	1,003	9,600	1,946
USS OGDEN	3,449	1,003	1,208	2,880
USS DULUTH	3,449	1,003	1,208	3,155

c. Steaming Costs

CINCPACFLT directed COMNAVSURFPAC to report "actual barrels of fuel consumed by type, and further categorized by transiting to scene, on scene, and transiting from scene". Ships were also directed to report the actual incremental OPTAR (operating target) costs incurred in direct support of the cleanup operation. (CINCPACFLT, Naval Message, 142246Z, JUL 89)

d. Other Costs

CINCPACFLT guidance defined "other costs" as temporary additional duty, repair parts, and other actual costs incurred in direct support of the cleanup operation (CINCPACFLT, Naval Message, 142246Z JUL 89).

e. Exxon Support

CINCPACFLT directed all commands to report the type, amount, and estimated value of food, supplies, parts, and personnel, as well as the number of barrels of fuel provided by Exxon at no charge to the Navy. In determining billings, CINCPACFLT deducted the amount of "free fuel" and other support items provided by Exxon from the total amount used by the ships during the operation.

f. Disagreements Over Criteria Used in Billing for Ship's Operations

The charges computed by CINCPACFLT for amphibious ship's support were directly affected by the number of days reported as associated with the cleanup effort. The issue of billing policy concerning transit time (time required for ships to travel to and from the cleanup site) became a point of controversy between DoD

and Exxon. On November 7, 1989, several billing issues were raised by Exxon in a meeting with representatives from the military departments involved (Office of the Comptroller, Department of the Navy, November 8, 1989). Exxon agreed that charging for transit time was appropriate but proposed three issues that it felt warranted consideration of recosting. First, Exxon questioned why DoD was billing for transit time in and out for all six ships used in the cleanup effort, when Exxon's original request had been for only two ships, the same two ships, to remain in the cleanup area for the duration. The Navy used six ships, rotating on a 56 day cycle, rather than the same two ships. The second issue involved disagreement over the actual transit time required to travel to and from the area. Exxon proposed that the two ships required only 14 days in, and perhaps 13 days out, for a total of 27 days. The Navy, on the other hand, argued that the six ships required transit time in of 38 days, and transit time out of 43 days, for a total transit time of 81 days. The third issue involved Exxon's contention that transit time should be viewed as "common costs" since "the crew could be going through the same training exercises whether the ship was headed to the

cleanup area or deployed on a Navy related mission". (Office of the Comptroller, Department of the Navy, November 8, 1989)

NAVCOMPT had provided COMNAVSURFPAC with transit time reporting guidance earlier in an administrative message sent out by CINCPACFLT, dated 142246Z JUL 89. NAVCOMPT defined three parameters for reporting transit time required in the cleanup effort:

1. If ship was at home port before being deployed to Valdez, time spent getting to and from scene is chargeable transit time.
2. If ship was at sea, time spent getting to scene is chargeable transit time.
3. If ship was at sea and involved in an exercise, time spent getting to scene is chargeable transit time. If another ship was ordered to replace the first ship, time spent getting to the exercise by second ship is also chargeable transit time.

The parameters described above reflect the procedures followed by CINCPACFLT, as evidenced by examination of the billings submitted. For the six ships involved in the cleanup operation, the average transit time in was 6.3 days, the average days on scene was 37.3 days, and the average transit time out was 7.1 days. CINCPACFLT billed Exxon for the transit time actually reported by

the individual ships, and billings could not be found which suggested the use of any other costing method. (CINCPACFLT, File Name RATE_REV.WK1)

3. Flight Operations

In billings submitted to the Coast Guard, CINCPACFLT included charges of \$1,588,176 for the costs of flight services provided by the Commanding General, Fleet Marine Force Pacific (CG FMFPAC) (CINCPACFLT, File Name SPECIAL.WK1). The FMFPAC Comptroller derived flight costs using actual flying hour data and the OP-20 flying hour cost report for the KC130 transports and CH46 helicopters used during the cleanup operation. The FMFPAC logged 157.3 flight hours in the KC130 transport, and 948.3 flight hours in the CH46 helicopter, for a total of 1105.6 flight hours devoted to support of the cleanup effort. A total of 122 officers and 161 enlisted personnel made up the flight crews for the two types of aircraft. CINCPACFLT calculated Marine personnel costs by using the flight hours reported by FMFPAC multiplied by the CSMR provided in NAVCOMPT Note 7041, dated 8 December 1988. The same acceleration factors used in deriving the Navy personnel costs (leave

and holiday and other personnel support costs factors) were also used by CINCPACFLT in deriving the Marine military personnel costs. Using these methods, the Marine personnel billings totalled \$497,407, which included \$344,386 for officers and \$153,021 for enlisted personnel. The remaining \$1,060,769 of costs reported by FMFPAC included OM&N costs, including fuel consumed, temporary additional duty, depot level repair, oil and lubricants, and other CPTAR costs. (CG FMFPAC, Naval Message, 160213Z OCT 89)

4. Lease of Landing Craft Mechanized (LCM)

In a lease agreement dated July 28, 1989, Exxon hired four LCM-8 landing crafts, twelve LCM-6 landing crafts, and one service waste oil barge (SWOB 049) for use in the cleanup operation. Through negotiations with the Coast Guard and COMNAVSURFPAC, Exxon agreed to pay \$560 per day for each LCM-6, \$814 per day for each LCM-8, and \$2,000 per day for SWOB 049. The agreement was to cover an initial period of sixty days, after which the lease would continue on a day-to-day basis at the established daily rental rate and "...until the vessels are redelivered" (Lease Agreement between United States of America and Exxon, July 28, 1989). Exxon provided

the operating crews for the vessels with the lease stipulating that

The Lessee shall be solely liable and shall hold harmless and defend the Government against any and all costs, expenses and liabilities arising with regard to the vessel(s)... (Lease Agreement between United States of America and Exxon, July 28, 1989, paragraph 7, p. 3)

Exxon rented the LCM's and SWOB from 28 July 1989 to 25 September 1989, for which CINCPACFLT submitted a bill of \$718 560 (CINCPACFLT, Military Interdepartmental Purchase Request, 06 Feb 90). Although the lease billing period was concluded on the 25th of September, redelivery of the landing crafts did not take place until late January, 1990. Paragraph 6(a) required the lessee to restore the landing crafts to overhaul condition, "including overhaul of all equipment to as good order and condition as when the vessel(s) was received...." Paragraph 6(b) stipulated that

Lessee agrees to restore the vessel(s) for any maintenance or repair of significant damage to the vessel(s) during operations related to the EXXON VALDEZ oil spill cleanup effort...

Since the lease agreement stated that the rental terms would continue until the vessels were redelivered, CINCPACFLT continued documentation and recording of charges through January 26, 1990, which resulted in accumulated charges of \$2,143,704

(CINCPACFLT, File name: SPECIAL.WK1). Although Exxon did, indeed, have possession of the landing crafts until late January of 1990, it was not charged for the additional days as a result of changes brought about by one of the three amendments later made to the original lease agreement. Amendment Number One, dated November 2, 1989, implemented the obligations of Exxon to repair the landing crafts as stipulated under Paragraph 6(b) of the original lease. Amendment One also revised the July 28th lease by stipulating that "Exxon's obligation to pay charter hire for the landing craft has ceased as of September 25, 1989". In addition, the Amendment listed the repairs to be made at Exxon's sole cost, plus the repair materials that would be provided by the Navy at no cost to Exxon. Redelivery of the landing craft was to take place only after both the Navy Port Engineer, and the Exxon representative were satisfied that the landing craft were "fully mission capable". In compliance with the revisions described, CINCPACFLT deducted \$1,425,144 from the accumulated charges, and submitted \$718,560 in charges to the Coast Guard on March 13, 1990 (CINCPACFLT, File Name SPECIAL.WK1). Amendment Number Two, dated March 17, 1990, listed additional

repair materials that would be provided by the Navy. Amendment Number Three, dated June 12, 1990, affirmed that Exxon had performed all its obligations, including "payment in full of all amounts to be paid under the lease."

I. SUMMARY

The size of the *Exxon Valdez* oil spill and its potential threat to the environment required an extensive cleanup operation involving ten federal agencies providing a wide variety of services. The GAO review of the cleanup effort pointed out the difficulties that can result from such an undertaking when there is a lack of clear and definitive guidance regarding the reimbursement process. In particular, the GAO report stated that "without applicable standards for developing spill related charges, agencies used a variety of different methods to develop their bills" (GAO Draft Report, March 1991, p. 55). As a result, GAO auditors discovered several inconsistencies in the cost accounting, reporting, and billing procedures followed by the federal agencies that were involved in the cleanup operation.

Due in part to the issues raised in the GAO review of the Valdez spill, Congress enacted in August of 1990 *The Oil Pollution Act of 1990*. This new Act addresses many of the problems that limited reimbursements in the *Exxon Valdez* cleanup operation, by expanding upon the definition of reimbursable activities. Specifically, the act establishes an Oil Spill Liability Trust Fund which authorizes agencies to recoup up to \$500 million for damage assessment and restoration costs incurred in each cleanup operation. (GAO Draft Report, March 1991, p. 4) However, the GAO report advised that, in establishing regulations to implement the Act, the Coast Guard should provide (1) a broad range of authorized cleanup activities, (2) procedures for the quick notification of agencies of the reimbursement process to be employed, and (3) guidance or policies which clarify standards and methods to be use in computing and recovering costs from the fund. (GAO Draft Report, March 1991, p. 5)

IV. ANALYSIS OF THE COST REIMBURSEMENT POLICIES AND PROCEDURES FOLLOWED IN ASSESSING PARAMOUNT PICTURES AND EXXON FOR DOD ASSISTANCE PROVIDED

A. INTRODUCTION

This chapter examines the similarities and dissimilarities that exist in the policies governing the billing practices followed by DoD in charging the Paramount Pictures Corporation and the Exxon Corporation for the services provided to each. Offered first is a review of the use of written agreements, followed by an examination of the billing policies governing each case. This includes a review of the billing procedures prescribed under each policy with a focus on the inconsistencies in their implementation. The chapter concludes with an examination of possible justifications for the differences found in DoD reimbursement criteria, as well as a brief review of billing policies and procedures found in other Federal Government regulations.

B. BACKGROUND

Although the purposes for the DoD assistance provided in each case are unique, the types of resources used are the same (i.e., ships, aircraft and personnel). Differences in the prescribed treatment of costs exist in DoD policies and/or Government regulations covering the three instances examined in this thesis. In addition to these differences in policy, each case also demonstrates inconsistencies in policy implementation.

C. WRITTEN AGREEMENTS

DoD does not consistently require the use of written agreements when providing assistance to private organizations. In DODINST 5410.16, dated January 26, 1988, DoD requires the military services to negotiate a written agreement with the motion picture or television producer prior to providing assistance in a commercial production. This "Reimbursement Agreement" must include a detailed description of the services to be provided and the estimated cost to be incurred by the Government. In addition, the agreement requires the producer to abide by DODINST 5410.16 which, in part, describes what types of assistance require reimbursement. (DODINST 5410.16, JANUARY 26, 1988)

In order to avoid many of the conflicts experienced in previous involvements with the entertainment industry, DoD clarified costing methods and provided specific billing guidelines through the implementation of the 1988 DODINST 5410.16. As a result of the revisions, many of the disagreements experienced in the *Top Gun* and *Final Countdown* productions did not recur in DoD's next major involvement with the entertainment industry, the production of *The Hunt for Red October*. This, however, may not have been due to the use of a Reimbursement Agreement, but instead due to the additional billing guidance provided in the DoD instruction. A member of the NAVINFO West staff stated that, "A Reimbursement Agreement was not required in *The Hunt for Red October* production since Paramount Pictures had established an adequate letter of credit." (NAVINFO West, February 21, 1991). Neither NAVINFO West nor CHINFO could provide the author with a Reimbursement Agreement covering DoD's involvement in that particular production. As a matter of fact, Paramount Pictures established Letters of Credit and Hold Harmless agreements for both *Top Gun* and *The Hunt for Red October* productions, although such agreements were not specifically required

by DoD instruction until incorporated into the revised DODINST 5410.16 - after the *Top Gun* production.

Contracts, like the Reimbursement Agreement, were not required by the Federal Government when DoD and the other federal agencies provided assistance to the Exxon Corporation in 1989. Many of the same difficulties encountered in the *Top Gun* production were also experienced in the *Exxon Valdez* cleanup operation. These included (1) the lack of clearly defined billing criteria, (2) the use of a wide variety of costing methods by the DoD components involved, and (3) disagreements over the reimbursement criteria (i.e., full versus incremental costs). In the *Exxon Valdez* cleanup, the Clean Water Act and the National Contingency Plan could be viewed as a type of Reimbursement Agreement, and the 311(k) fund as a type of letter of credit, although both do not achieve the same reimbursement assurances as those used in DoD dealings with the entertainment industry. The Clean Water Act and the National Contingency Plan provide predesignated roles and coordinated plans for immediate response to a major oil spill, but they do not provide specific criteria and procedures for determining and calculating

charges to bill the organization responsible for the spill. There was confusion among the agencies involved in the *Exxon Valdez* cleanup effort as to what reporting and billing procedures were to be followed. The March 1991 GAO report stated that this confusion was the result of the Coast Guard's failure to provide specific billing guidance and, in some cases, failure to simply notify agencies that the 311(k) fund was actually going to be used, until weeks after the cleanup operation had begun (GAO Draft Report, March 1991, p. 51). Participating DoD components "anticipated" that a majority of their expenses would be reimbursed through the pollution fund (JTF-AK Elmendorf, 271700Z APR 89). Most of the charges submitted by DoD were reimbursed, but not all. The lack of detailed, pre-service, agreements and specific billing guidance resulted in disagreements with the Coast Guard over reimbursement criteria, as well as what activities qualified for reimbursement under the Clean Water Act and/or the National Contingency Plan.

The absence of clear guidance and agency unfamiliarity with billing procedures for this type of assistance resulted in millions of dollars of under and over billed charges to Exxon. Examples include

the failure of several agencies to bill for asset use charges and full retirement costs for personnel involved in the cleanup effort. These expenses are discussed in greater detail in subsequent sections. The lack of agreements similar to the Reimbursement Agreement required by DoD in dealings with the entertainment industry contributed to DoD's recoupment of less than 42 percent of the cost incurred in the *Exxon Valdez* cleanup operation.

Although the Oil Pollution Act of 1990 attempts to curtail such problems in future oil spills, a determining factor will be the wording of its implementing regulations, which the Coast Guard is currently in the process of preparing. The immediate action required in response to a major oil spill prevents case by case preparation of written agreements with the responsible spiller prior to providing the necessary cleanup and containment activities. However, regulations can be implemented which specify the reporting, billing, and reimbursement procedures to be enacted when such an incident does occurs.

D. BILLING POLICIES

With respect to the policies governing reimbursement for services provided to a private party, differences exist as to the costs that are to be recovered. Table 6-1 provides a summary of the main differences in reimbursement policy found among the three cases examined.

Table 6-1

POLICY GOVERNING REIMBURSEMENT FOR SELECTED COSTS

Case Costs	Top Gun	The Hunt for Red October	Exxon
Military/Civilian Personnel Costs	All Personnel Costs Incurred	Civilian Overtime Only	All Personnel Costs Incurred
Use of Aircraft (Rate similar to:)	Non-Government User Rate	DoD User Rate	Non-DoD/Other Federal User Rate
Use of Ships and Other Vessels	Hours Deployed Solely for the Production	Rates Derived to Recoup Fuel and Maintenance Costs	Rates Derived to Recoup Fuel, Personnel and Maintenance costs
Asset Use Charges	4% of Direct Costs	None	4% of Direct Costs
Administrative Surcharges	3% of Total Costs	3% of Total Costs	3% of Total Costs

Differences in DoD reimbursement policy are demonstrated when examining DODINST 5410.16 and DODINST 7230.7. While DODINST

5410.16 calls for recoupment for any "additional costs" incurred as a result of assistance rendered, DODINST 7230.7 calls for either the recovery of the "full cost" incurred by the Federal Government, or the fair market value, whichever is higher. Section III of the NAVCOMPT manual, entitled *Private Parties*, calls for similar recoupment of the "full cost incurred by the Department of the Navy..." (NAVCOMPT Manual 035875 (b)1).

Differences in billing procedures arose from the different definitions of the costs to be recouped and from the selective employment of guidelines from different instructions. These differences are highlighted when comparing the costing methods and billing criteria used by DoD in the dealings with Paramount Pictures with those followed in DoD's involvement with Exxon.

Had DoD not implemented changes in cost reimbursement policy through revision of DODINST 5410.16, Paramount Pictures would have been assessed a greater amount of charges for the services provided in *The Hunt for Red October* production. The cost reimbursement policy followed in the *Exxon Valdez* case, which was similar to that used in the *Top Gun* production, required

reimbursements from Exxon for amounts greater than would have been assessed had the billing policy been similar to that followed in *The Hunt for Red October* production.

The following is a comparison of the billing procedures used to derive charges as prescribed under the three policies. In particular, three major cost categories are examined: (1) Military and Civilian Personnel Costs, (2) Aircraft, Ship, and Other Military Equipment Costs, and (3) Asset Usage/Administrative Surcharges.

1. Military and Civilian Personnel Costs

Revision of DODINST 5410.16 introduced a major shift in DoD policy regarding reimbursement for military and civilian personnel costs incurred in providing production assistance to the entertainment industry. In the *Top Gun* production, DoD policy required Paramount Pictures to reimburse the Navy for all personnel expenses incurred. This included charges for the salaries of flight crews; services such as towing aircraft, dearming ejection seats, and rigging the flightdeck barricade; as well as civilian personnel costs for orientation briefings and time spent in meetings and telephone conversations. CINCPACFLT used the CSMR, adjusted by the

"leave and holiday" and "other personnel support cost" acceleration factors to recover the full cost incurred by the government.

For military and civilian personnel costs incurred during *The Hunt for Red October* production, CINCPACFLT charged Paramount Pictures for civilian overtime charges only. This was in accordance with the policy prescribed in the revised DODINST 5410.16 which mandates that the production company is not required to reimburse the Government for military or civilian personnel, when "such personnel are officially assigned to assist in the production." The author was unable to obtain, from any of the DoD commands contacted, a clarification of who was considered "officially assigned" or what method of assignment was required (i.e., written orders for specific individuals, verbal orders to DoD components by NAVINFO or CHINFO). Under this clause, CINCPACFLT did not bill Paramount Pictures for the hours devoted to the production by NAVINFO and CHINFO personnel or for the hours contributed by the staffs of the Comptroller and PAO offices involved. In addition, CINCPACFLT did not submit billings for services such as the background checks performed by the Naval Intelligence Service or for the

aviation/swim physiology classes required for the cast and filming crews who would embark in military helicopters. Such costs could be considered "additional expenses incurred as a result of assistance rendered," but the personnel providing these types of services were considered "officially assigned to the production."

A policy similar to that governing billing procedures used in the *Top Gun* production was also followed in billing Exxon for the military and civilian personnel costs incurred in the *Exxon Valdez* cleanup operation. In both cases, CINCPACFLT used the CSMR from the applicable NAVCOMPT Note 7041 and adjusted the rates by the same acceleration factors: 14 percent leave and holiday rate for both officers and enlisted and the other personnel support costs rates of 6 percent for officers and 18 percent for enlisted. However, in the *Exxon Valdez* case, the GAO report points out that there were inconsistencies among the federal agencies in the implementation of policy with respect to the application of these acceleration factors. For example, the Coast Guard did not include adjustments for retirement costs, and both the Department of the Interior and the FAA did not include adjustments for leave and

holiday accruals (GAO Draft Report, March 1991). In accordance with the applicable NAVCOMPT Note 7041, the CINCPACFLT Comptroller considered the retirement rate to already be incorporated in the CSMR and applied acceleration factors to recoup leave and holiday and other personnel support cost (CINCPACFLT, File Name MPN_REV3, 17 AUG 89).

Another difference between the policy followed in the *Top Gun* production and that followed in the *Exxon Valdez* operation was in the methods prescribed to report and assess charges for personnel support. Billing guidance in the *Top Gun* production required commands to report the particular service performed, as well as the time required in minutes. This provided an accurate measure of the costs incurred as a direct result of rendering a service to that organization. In the *Exxon Valdez* case, CINCPACFLT billed Exxon, using a daily charge derived for each rate/rank, for every member aboard ship, regardless of the particular duties performed. This included charges for military personnel who performed services not directly related to the cleanup effort. For example, CINCPACFLT included in its billings charges for services performed by a ship's

Mess Specialists (cooks), Enginemen (responsible for such things as the repair and upkeep of auxiliary equipment, air conditioning systems, and diesel engines), Electrician Mates, and ship's Servicemen (barbers, ship's store and laundry personnel).

CINCPACFLT calculated military and civilian personnel costs by multiplying the daily rates by the number of days reported as transit time and days on scene. As mentioned earlier, this policy was an area of contention between DoD and Exxon. Exxon expressed concern that some consideration should be given to recosting charges for transit time, since many of the expenses incurred could be viewed as common costs. Many of the types of personnel costs described above would be incurred by DoD whether the ship was involved in an oil cleanup operation off the coast of Alaska or deployed elsewhere. In fact, the Navy would incur many of the same personnel costs if the ships were in port. In addition, the Navy conducted military training exercises in conjunction with the cleanup effort. This included exercises such as General Quarters, Man Overboard drills, and fire fighting training. However, no billing adjustments were made in consideration of these common costs.

The policy of charging Exxon for all personnel costs, based on both the days spent in transit and on scene, is also in sharp contrast to the policy followed in billing for flight services provided to Paramount Pictures in *The Hunt for Red October* production. In that production DoD required commands to charge for all flight hours devoted to the production, "except when such missions coincide with and can be considered legitimate operational and training missions" (DODINST 5410.16 E4(b), January 26, 1988). Paramount Pictures was not billed in all cases for flight hours logged in ferrying aircraft to a filming location, since some military training was accomplished during the transit (i.e., low level and air combat training exercises). Exxon, in effect, was arguing for a similar policy implementation with respect to ship operations. Although DoD billing guidance calls for recoupment of only those additional expenses incurred in rendering services to the entertainment industry, in the *Exxon Valdez* case DoD required full reimbursement of the costs incurred without any consideration of the distinction between "common" and "additional" cost.

2. Aircraft, Ship, And Other Military Equipment Costs

a. Charges for the Use of Aircraft

In order to avoid flight hour billing disagreements with the entertainment industry, like those encountered in the *Top Gun* and *Final Countdown* productions, DoD introduced policy revisions in the 1988 DODINST 5410.16. Although this instruction clarifies which actual flight hours require reimbursement, it does not provide procedures for the pricing of these services. That responsibility is left to the Services and is sometimes further delegated to the individual activities providing those flight hours.

Flight hour rates were derived on a case by case basis, and this resulted in a variety of user rates, as well as a lack of standardization among the Services. Personnel from both the COMNAVAIRPAC and CINCPACFLT Comptroller Offices stressed the need for established standard reimbursement rates similar to those already provided in the NAVCOMPT Manual for various types of military helicopters. NAVCOMPT Manual 035882 provides three categories of flying hour reimbursement rates:

1. A DoD User Rate, used for billing other DoD components. The rate is derived to recoup expenses for petroleum, oil, lubricants, depot maintenance, supplies, replenishment spares, and civilian pay.
2. A Non-DoD/Other Federal User Rate, used for billing U.S. Government agencies outside DoD. The rate includes the DoD rate plus military pay and permanent change of station costs.
3. A FMS(Foreign Military Sales)/Non-Government User Rate used for billing non-government users. The rate includes the items covered by the previous two rates plus an asset use charge and a general and administrative surcharge.

Policy governing the flight hour rates for the types of aircraft used in the *Top Gun* production resulted in rates similar to the FMS/Non-Government Rate for helicopters in that they include charges for military pay, an asset use charge, and an administrative surcharge. Policy followed by COMNAVAIRPAC in *The Hunt for Red October* production resulted in derived rates similar to the DoD User Rate in that the flight hour rates include charges for fuel and depot level repairables. Military pay was excluded in accordance with the

revised DODINST 5410.16. In effect, the Navy billed Paramount Pictures for flight services provided in *The Hunt for Red October* at a rate less than it would charge for similar services provided to a U.S. Government agency outside DoD if billing was in accordance with the guidelines established in NAVCOMPT Manual 035882.

Although an actual rate per flying hour was not applied in the *Exxon Valdez* case, the policy followed by the Commanding General, FMFPAC resulted in assessed charges similar to those that would have been derived had the Non-DoD/Other Federal User Rate been used. Costs for military pay were reimbursed as well as charges for fuel, oil, and depot level repairs. Asset use and administrative surcharges were not identified in the billings examined. Personnel from the FMFPAC Comptroller Office were unable to confirm whether such charges were included.

Justification for the differences in policy concerning the costs billed to these two private parties for the same types of flight services was not found.

b. Charges for the Use of Ships and other Naval Vessels

The policies covering the use of Naval vessels in all three cases are similar in that each required reimbursement for such costs as fuel, oil, and maintenance. Although the Navy did not assess Paramount Pictures for any ship operations during the *Top Gun* production, reimbursement criteria prescribed in the applicable policy were similar to those followed in the other two cases. However, one difference in policy does exist among the three cases which is the result of the variances discussed earlier regarding the treatment of military and civilian personnel costs. DoD policy required that the rates used in the *Exxon Valdez* case also include charges for all personnel costs incurred. (This billing procedure is discussed in more detail later in the section.)

Several inconsistencies were discovered in the implementation of policy governing ships' support provided in *The Hunt for Red October* production. These inconsistencies appeared to result from the lack of established billing procedures. This became evident when seeking information concerning the reimbursements requested for this type of assistance. None of the staff who were contacted at

the commands contributing to *The Hunt for Red October* production, including the Comptroller and Public Affairs Offices, could explain who was responsible for deriving the hourly rates used or how they were calculated. Those contacted did report that, in accordance with guidance provided in DODINST 5410.16, charges included only fuel and maintenance expenses, and not military personnel costs.

Regarding the use of nuclear submarines in *The Hunt for Red October* production, a staff member of NAVINFO West explained that the \$397 per hour rate was based on the yearly costs derived by dividing the acquisition cost of the nuclear reactors aboard by their estimated useful life. A staff member of COMSUBTRAFAC, on the other hand, reported that the rate was derived to recoup the costs of the fuel, oil, lubricants, and general maintenance required on the submarines. Personnel from the COMSUBPAC Comptroller Office were unable to confirm which billing procedures were followed.

A variety of rates were also used by the commands providing tugboat services in *The Hunt for Red October* production. For tugboats of the same type (i.e., engine size, tonnage), hourly rates ranged from the \$225 charged by Naval Station Long Beach to

the \$52.50 charged by the Naval Undersea Warfare Engineering Command. Staff at some of the commands reported that their rates were developed to recover the costs of fuel and oil consumed, while others reported that their rates were based on the expenses incurred as a result of hiring a civilian tugboat to replace the Navy tugs used in the production. None of the staff at the commands contacted were aware of the formula provided in NAVCOMPT Manual 035881 for deriving rental rates for Navy tugboats, or whether or not this formula had been used by the personnel computing the charges. Examination of the billing guidance provided by NAVINFO West, CHINFO, and CINCPACFLT during the production made no reference to this formula.

Although DoD has established policy covering the reimbursement for these types of services, the inconsistencies in policy implementation suggest a need for additional DoD billing guidance and procedures in order to curtail such inconsistencies.

Another example of inconsistent implementation of policy was found in the *Exxon Valdez* case. DoD submitted billings to recover the full costs of the ships' support provided. This in-

cluded charges ranging from \$17,126,875.00 for military personnel to \$372.00 for laundry equipment repairs. The charges for military personnel were based on the number of days spent in transit and on scene. However, charges for the three types of maintenance costs were tabulated by multiplying the daily rates, derived by the Office of the Comptroller of the Navy, by the number of on-scene days only. None of the commands contacted, including CINCPACFLT and the Navy Comptroller, could explain why these same rates were not also applied to the days in transit.

3. Asset Use and Administrative Surcharges

Both DODINST 7230.7 and the NAVCOMPT Manual (paragraph 035875) provide policies requiring an asset usage charge to cover depreciation and interest on investment in DoD owned fixed assets. The NAVCOMPT Manual prescribes the specific rate of four percent of direct costs, while the DoD instruction refers to the current annual rate provided in OMB Circular Number A-94.

In accordance with DoD policy, CINCPACFLT charged Paramount Pictures an asset use charge for the aircraft, forklifts, and other equipment used in the *Top Gun* production. However, a GAO

audit reported that this billing practice was not applied consistently in that an asset use charge was not applied to Navy cameras used in the production (Inspector General, 1986).

In accordance with the policy applicable to *The Hunt for Red October* production, CINCPACFLT did not charge Paramount Pictures an asset use charge; such charges were prohibited under guidance prescribed in the January 21, 1988 DODINST 5410.16.

In contrast, policy governing the *Exxon Valdez* case resulted in asset use charges of \$1,290,221 for the six FFG's used in the cleanup operation. The daily asset use rate derived by the Office of the Comptroller of the Navy was applied only for those days reported as on scene. The author was unable to obtain reasons why the asset use rate was not also applied to days in transit.

Regarding policy governing asset use charges, the GAO refers to several sources of guidance in its March 1991 report on the *Exxon Valdez* cleanup operation. The report states that, in accordance with OMB Circular A-25, *User Charges*, "...federal agencies should recover their costs for services or benefits they provide to recipients, including depreciation of equipment."

The policies are similar with respect to the use of administrative surcharges when examining each of the three cases. However, inconsistencies in the implementation of these policies were found.

In accordance with NAVCOMPT Manual 035875, paragraph 1b(2), CINCPACFLT assessed Paramount pictures an administrative surcharge of \$3,281.63, or 3 percent of total costs for the assistance provided in the *Top Gun* production. This same billing policy was applied in *The Hunt for Red October* production, with CINCPACFLT assessing Paramount Pictures a total of \$9,472.28. Although the same policy was found governing the *Exxon Valdez* operation, there were inconsistencies in its application. DoD did not bill for overhead or for administrative costs in all cases. Specifically, "...the Navy did not charge the required 3% for indirect costs for its barracks ships". (Office of the Deputy Comptroller, Management Systems, December 11, 1990)

Although these three cases demonstrate similarity in policy with respect to the use of administrative surcharges, a difference in policy was found regarding the requirement for asset use charges.

Inconsistencies in the implementation of policy were also discovered with respect to both types of charges.

E. POSSIBLE JUSTIFICATIONS FOR INCONSISTENCIES IN COST REIMBURSEMENT POLICY FOLLOWED BY DOD

The author was unable to identify justifications, based on cost accounting principles alone, for the differences in cost reimbursement policies governing the three undertakings. However, it can be argued that dissimilarities in the policies may exist due to the varying degree of incentives in providing each of these services. For example, the positive incentives involved with the production of a movie such as *Top Gun*, which glamorizes the Navy and might serve as a valuable public relations tool, could have had some influence upon DoD in determining the costs to charge to the Paramount Pictures Corporation. When asked to explain the possible justification for the difference in the cost reimbursement policy accorded to Paramount Pictures and the Exxon Corporation, the Special Assistant (Audiovisual) from the Office of the Secretary of Defense (Public Affairs) responded: "We want the entertainment industry to continue to make great pictures about us . . . Motion pictures, like

Top Gun, are valuable means of recruitment, and help to improve public perceptions of the military." (Strub, Feb 21, 1991)

A similar sentiment was expressed by the Director of the Advertising Operations Division, Navy Recruiting Command (COMNAVCRUITCOM), in a letter to the Washington representative of the Alliance of Motion Picture and Television Producers. The Director states, "I am hopeful it [*Top Gun*] will generate much positive visibility for Naval aviation, and will bolster Navy recruiting efforts to both our target audience and to influentials." (Sherwood, September 20, 1985)

Although these anticipated benefits may suggest an explanation for the differences found in policies, the actual benefits generated by such movies may not be as significant as perceived. At the request of COMNAVCRUITCOM, a survey of 511 men, 18 years of age and older, was conducted in July, 1987 by *OmniTel*, a weekly telephone omnibus service. The survey was initiated after COMNAVCRUITCOM detected, through a Navy Advertising Effectiveness Survey, a significant increase in Air Force advertising awareness that could not be justified by Air Force advertising expenditures.

The *OmniTel* survey, in part, asked "What branch of the U.S. military is featured in the movie *Top Gun*?" In response, 28 percent of those seeing the movie correctly identified the Navy as the branch featured, 38 percent responded that the Air Force was featured, and 30 percent didn't know which branch of service was featured in the picture. The target audience (18 to 24 year old males) showed more favorable results, with 54 percent correctly identifying the Navy as the military branch featured. In addition, in answer to the question, "Which branch of the military had aircraft carriers?", 85 percent of the respondents correctly identified the Navy, 10 percent responded the Air Force, 1 percent the Army, and 4 percent didn't know which branch of the military had aircraft carriers. (COMNAVCRUITCOM, July, 1987)

A similar survey was conducted in May and June of 1990 to evaluate the effects of the motion picture *The Hunt for Red October*. According to COMNAVCRUITCOM, the survey showed that the movie had a favorable effect on the public's perceptions of the Navy, as well as on decisions to join. Of the 1,383 males contacted in the survey, 211, or 13.8 percent, were members of the target audience

(18-24 years old). Of these 211 males, 49 individuals, or 23 percent, actually saw the movie. The survey showed that, of those 18-24 year old respondents who had seen the movie, 27.4 percent now had a more favorable opinion of the Navy, and 25.7 percent were now more likely to recommend joining. (There may be some error, other than rounding, in the COMNAVCRUITCOM percentages reported, since 27.4 percent of 49 is 13.426 respondents.) Results of the survey also showed that 18.9 percent of the target audience responded that they were now less likely to recommend joining the Navy. The Navy Recruiting Command concluded that

The survey shows that movies such as *The Hunt for Red October* enhance the Navy image and impact on the decisions to join on a limited basis in the target market. Favorable movies definitely help but not to the extent that some would like to believe in this case. (COMNAVCRUITCOM, 6 June 1990)

The movie industry estimates that only 16 percent of the public sees any one movie. In contrast, COMNAVCRUITCOM estimates that 76 percent of the target audience has recently heard or seen a Navy advertisement. (COMNAVCRUITCOM, 6 June 1990)

In addition to the surveys completed by the Advertising Department, the Navy Recruiting Command Research and Studies

branch also conducted a study after the release of *Top Gun*, which indicated no change, observable or measurable, in recruitment levels (Kannapel, telephone conversation, May 21, 1991).

Although DoD (i.e., NAVINFO West and CHINFO) may have anticipated some recruitment benefits from participation in the production of the two motion pictures, these COMNAVCRUITCOM studies and surveys do not strongly support the existence of recruitment benefits.

Although recruitment benefits do not substantiate the different cost reimbursement policies accorded to each of the private corporations, another possible justification was offered by the Director of NAVINFO West. The Director stated that DoD policy did not require production companies to make reimbursements for military personnel expenses, in part because of the artistic control that the military now has in the productions. In reviewing the 200 to 250 scripts received each year, NAVINFO West often makes changes and revisions in order to achieve a more accurate portrayal of military life. These revisions often result in the use of additional military personnel in filming scenes and in gathering

necessary technical advice. Therefore, at the time revisions were being considered for the 1964 DODINST 5410.16, both NAVINFO West and the Office of Secretary of Defense (Public Affairs) felt that it was inappropriate to bill production companies for military personnel costs (Director, NAVINFO West, telephone conversation, February 21, 1991). However, it can be argued that DoD could maintain the same level of artistic control in the productions even if such costs were included in the required reimbursements. The demand for DoD assistance in commercial productions by the entertainment industry may indeed decline with the inclusion of such costs, but this may have little impact upon the number of productions eventually receiving DoD assistance or the level of DoD artistic control in each. The large number of script proposals reviewed by NAVINFO West each year (200 to 250), in comparison to the number of productions actually receiving assistance (One or two), demonstrates a level of demand for services well above the amount DoD has accorded to such undertakings in the past.

F. LACK OF STANDARDIZATION IN DOD BILLING PROCEDURES

The one similarity that exists across each of these three cases is the lack of standardization in implementing the established billing policies. There are a number of sources of guidance and detailed billing procedures covering those transactions in which the Government purchases or contracts for services and material from private organizations. These include the Federal Acquisition Regulation (FAR), the Defense Acquisition Regulation (DAR), the Code of Federal Regulations (CFR), and the Cost Accounting Standards (CAS). (The DAR was incorporated as a supplement to the FAR in 1986 and was retitled DoD Federal Acquisition Regulation Supplement (DFARS)). However, these sources provide little guidance, if any, for billing procedures to follow in those instances in which the provider of services is now the government and the recipient is a private, nondefense, enterprise. Other than the two DoD instructions governing services provided in commercial productions, DoD/Government accounting policies and procedures are simply not designed to address these specific types of atypical transactions. For example, the CFR stipulates that the FAR System

"...is established for the codification and publication of uniform policies and procedures for acquisitions by all executive agencies."(48 CFR 1.101). The CFR provides a similar description of DAR, in that it establishes policies governing procurements by DoD from industry, and not vice versa.

The March 1991 GAO report on the *Exxon Valdez* stated that "Agencies could have used existing guidance in OMB Circulars and the Cost Accounting Standards..." The report made several references to instances where agencies were unaware of or failed to use the Cost Accounting Standards in establishing billing procedures (GAO Draft Report, March 1991). The GAO report refers to Cost Accounting Standard 409, *Depreciation of Tangible Capital Assets*, when it states that the "National Park Service erred in determining their spill costs because NPS officials were not aware of the provisions of this standard" (GAO Draft Report, March 1991, p. 55). There is, however, no reason to believe that the CAS's were applicable to the *Exxon Valdez* case, or to the two dealings with Paramount Pictures. Section 719(g) of the Defense Production Act of 1950 mandates that the CAS's Board establish "...cost accounting standards designed to

achieve uniformity and consistency in the cost accounting principles followed by defense contractors and subcontractors under Federal contracts." Similarly, the CFR states that the Cost Accounting Standards Board was established

...to implement the Defense Production Act of 1950, which provides for development of Cost Accounting Standards to be used in connection with negotiated national defense contracts and for cost accounting standards to be used in such contracts (4 CFR 331).

The CAS define national defense, as used in this context, as "...any program for military or atomic energy production or construction, military assistance to any foreign nations, stockpiling, space, and directly related activity." (4 CFR 331.20(d)) This definition and the described purpose of the CAS's do not seem to be applicable to the three cases examined. In addition, Section 331.30 of 4 CFR describes categories of contracts and subcontracts which are exempt from all CAS requirements. Among these are:

- 1) Contracts and subcontracts of \$500,000 or less if business unit is not currently performing any national defense CAS-covered contracts.
- 2) Nondefense contracts and subcontracts awarded to business units that are not currently performing any CAS-covered national defense contracts.

The author was unable to ascertain whether or not Paramount Pictures or Exxon was concurrently involved in any CAS-covered national defense contracts at the time of these three cases. According to the CINCPACFLT Comptroller's Office, and from examination of related documentation, CAS guidelines were not used in deriving charges to assess Paramount Pictures for DoD services rendered in the *Top Gun* or *The Hunt for Red October* productions. The March 1991 GAO report implies that its authors considered the *Exxon Valdez* oil spill cleanup operation subject to the CAS requirements.

The CFR provides billing guidance covering two types of transaction in which DoD provides services or materials to a private party. Part 251 of 32 CFR, entitled *Sale of Government Furnished Equipment or Material and Service to U.S. Companies*, applies, in large part, to those services and materials that are being supplied to companies "...for final assembly or final manufacture into an end item for use by the Military Services." (32 CFR 251.6) This does not apply to those services provided by DoD in the three cases examined. Part 863 of 32 CFR, entitled *Leasing of USAF Aircraft and Related Equipment to Nongovernment Organizations*, outlines policies and

procedures for leasing aircraft for such uses as international airshows and foreign military sales. Procedures prescribe the use of asset use charges, administrative surcharges, and flying hour rates to recoup expenses for such items as depot maintenance and base support.

Part 288 of 32 CFR, entitled *User Charges*, describes a policy very similar to those found in DODINST 7230.7, OMB Circular A-25, and NAVCOMPT Manual 035875(b), each also entitled *User Charges*. All four guidances call for charges in order for the Government to recover the full cost of rendering a service or the fair market value, whichever is higher. Although not specifically required, each proposes the use of charges to recover the full cost of military personnel services, as well as charges for depreciation and interest on investment.

G. SUMMARY

There is a variety of sources available which provide billing guidance covering Government acquisitions of services and material from private organizations. However, the same cannot be said for

those situations in which the roles of seller and purchaser are reversed. Although DoD instructions and Government regulations provide some guidance, examination of the billing procedures used in the three cases demonstrates a difference in policies concerning reimbursement criteria. In addition, the variety of billing procedures used in implementing the different policies demonstrates the need for standardization and further guidance to clarify the specific steps to use in computing charges for DoD assistance provided to private organizations. Differences in DoD policies and the criteria for reimbursement of costs incurred do not appear to be based on cost accounting principles. The differences appear to be based on perceived recruitment benefits or loosely defined criteria such as artistic control.

VI. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

A. SUMMARY

This thesis presented an examination of the cost reimbursement policies and billing procedures followed by DoD when providing services to

1. The Paramount Pictures Corporation for the filming of the motion pictures *Top Gun* and *The Hunt for Red October* and
2. The Exxon Corporation in support of the *Exxon Valdez* oil spill cleanup operation.

The purpose of this examination was to determine what, if any, dissimilarities existed in the reimbursement policies accorded to each of these private corporations. This included an analysis of the inconsistencies found in the implementation of the various policies.

Chapter I provided introductory and background information concerning the policies and instructions which governed DoD assistance provided to the two private parties. In addition, the chapter described the thesis objectives and methods of research.

Chapter II presented a detailed examination of the DoD cost reimbursement policy governing the assistance provided to Paramount Pictures in the production of the motion picture *Top Gun*. This included a review of the costs incurred and the billing procedures followed by the U.S. Navy in providing this assistance.

Chapter III reviewed changes made in DoD policy, after the *Top Gun* production, governing assistance in entertainment-oriented commercial productions. This included an in depth examination of the additional billing guidance provided and the changes in reimbursement criteria, which were implemented through revision of DODINST 5410.16.

Chapter IV presented a detailed examination of the DoD billing policy governing the assistance provided to Paramount Pictures in the production of the motion picture *The Hunt for Red October*. This included a review of the costs incurred and the billing procedures followed by the U.S. Navy in providing this type of assistance.

Chapter V described the Federal Government's involvement in the *Exxon Valdez* oil spill cleanup operation and the procedures followed in determining the costs to assess the Exxon Corporation

for assistance provided. This included an examination of the cost reimbursement policies administered by the U.S. Coast Guard.

Chapter VI provided a comparison of the policies and billing procedures followed in each of the three cases. This included an examination of the dissimilarities in policy regarding the treatment of charges assessed to each of these private parties, as well as the inconsistencies found in policy implementation. Also discussed were possible justifications for the differences in policy.

This chapter summarizes the conclusions drawn from the analysis, provides recommendations for possible improvements, and suggests topics for further research.

B. CONCLUSIONS

- 1. The DoD billing policy and procedures mandated in DODINST 5410.16 and 5410.15 are not consistent with the reimbursement policy described in other Federal Government regulations.**

Of the DoD billing policies examined, the two DoD instructions cited above are the only examples of policies which do not call for charges to recover the full cost incurred in providing assistance or the fair market value, whichever is higher. DoD

instructions, governing assistance provided to an entertainment oriented business, prohibit the Services from assessing charges for services that would otherwise be billed if dealing with other types of industry. Policies followed in the *Top Gun* production, prior to revision of DODINST 5410.16, were more representative of the Federal Government's general policy of recoupment of full cost, as contrasted with the billing policy followed in *The Hunt for Red October* production.

Differences in reimbursement criteria were also demonstrated in the comparison of the billing policies governing services provided to Paramount Pictures versus those policies governing reimbursements for assistance provided to Exxon. Examples of services billed to Exxon and not Paramount Pictures include the full cost of military and civilian personnel and asset use charges. The evidence reviewed for this thesis does not support the conclusion that the differences in policy are justified by the perceived recruitment benefits and artistic control of commercial productions.

2. The lack of clarity in billing guidance and in the criteria for reimbursements resulted in the use of a variety of billing practices.

Although the revised DODINST 5410.16 provides additional billing guidance and procedures when dealing with the entertainment industry, DoD components involved in *The Hunt for Red October* production continued to use a variety of billing procedures when implementing established policy. Examples include

- a. the variety of methods used in determining appropriate charges for the tugboat services provided,
- b. the use of a Special Deposit by the Puget Sound Naval Shipyard for services provided in *The Hunt for Red October* production, even though a letter of credit had already been established for the production, and
- c. the variety of flight hour rates that exist among the Services for the use of the same types of aircraft.

In the *Exxon Valdez* oil spill cleanup operation, the lack of clearly defined billing procedures caused confusion and disagreement over the reimbursement process. The use of a variety of billing procedures contributed to agencies failing to recover the full costs incurred.

3. DoD Policy requirements for written agreements were inconsistent

Policy provided in DoD instructions applicable to assistance provided to the entertainment industry mandates the use of a Reimbursement Agreement, Hold Harmless agreements, and a letter of credit or advance payment. Similar agreements were not required in the *Exxon Valdez* operation (other than the Hold Harmless stipulation found in the LCM lease agreement). The lack of explicit agreements prior to the provision of that assistance resulted in reimbursement disagreements that otherwise might have been avoided. Although the immediate action required in response to a major oil spill prevents case by case preparation of written agreements, regulations can be implemented which specify the reporting, billing, and reimbursement procedures to be enacted when such an incident does occurs. The Clean Water Act and the National Contingency Plan provide a basic framework for the billing and reimbursement process, but they do not provide the same level of detailed instruction and recovery assurances as does the use of Reimbursement Agreements and letter of credit in DoD dealings with the entertainment industry.

C. RECOMMENDATIONS

1. Standardization of billing policies.

DoD instructions governing reimbursement for services provided to the entertainment industry should be revised in order to be more consistent with the policies covering similar transactions with other types of industries. These revisions should include

a. Reimbursement for the full cost of military and civilian personnel costs incurred, similar to the procedures followed during the *Top Gun* production and the *Exxon Valdez* oil spill cleanup operation, and

b. The use of asset use charges to cover depreciation and interest on investment in DoD owned fixed assets.

Similar billing policies should also be incorporated into the Coast Guard regulations implementing the Oil Pollution Act of 1990. Along with clarifying what activities will be authorized and reimbursed, the Coast Guard should establish clearly defined methods for computing and recovering costs. The regulations should include instructions for an asset use charge and administrative surcharge, as well as a uniform procedure for recovering the full

cost of military and personnel costs incurred (i.e., the use of specific acceleration factors in order to remove billing inconsistencies among the Services).

Both Coast Guard regulations and DoD instructions should also include adjustments for common costs such as the personnel expenses incurred in normal operations which are not related to the services being rendered to the private party (i.e., the salaries of Electrician Mates and Engineermen, and costs incurred in conducting coinciding military training exercises). Companies responsible for pollution and private organizations in the entertainment industry should be accorded the same billing considerations concerning flight hours, ship operations, and personnel expenses. DoD billing policies and Coast Guard regulations should be consistent in that both require reimbursements for the full costs incurred in providing assistance to private organizations. With respect to the Coast Guard regulations implementing the Oil Pollution Act of 1990, it is important that each of the federal agencies affected play an active role in their development.

2. Standardized flight hour rates

DoD should establish flight hour rates for military aircraft similar to those already published in the NAVCOMPT Manual for helicopters. This will eliminate the inconsistencies in cost reimbursements which exist among the Services and establish uniform billings based on the nature of the recipient (i.e., DoD, Non-DoD/other federal agency, and FMS/Non-Government).

D. SUBJECTS RECOMMENDED FOR FURTHER RESEARCH

Several issues, which were beyond the scope of this thesis or only briefly examined, warrant further research. These topics are described below.

DoD was involved in a variety of motion picture and television productions throughout the 1970's and 1980's, and this thesis provided an assessment of the billing practices followed in just two of those productions. Examination of more recent dealings with the entertainment industry may provide further insight into the question of consistency in billing practices. Suggested areas of investigation are the productions of *Flight of the Intruder*, *Navy Seals*, and the

television series *Supercarrier*. Research could also focus on the criteria used by DoD in selecting, from the 200 to 250 proposals received each year, the one or two productions which actually receive DoD assistance. Although some reference was made to USAF regulations, this thesis focused mainly on the billing practices followed by the Navy. An area for additional review may be a more thorough examination of the policies established by the other Services to recover costs incurred in providing this type of assistance. Differences in billing procedures may or may not be discovered.

Some aspects of the *Exxon Valdez* oil spill cleanup operation indicates that further research may be of value. Disagreements continue over the reimbursement process used in the operation, with federal agencies still seeking reimbursements for services not authorized by the Coast Guard. The Coast Guard is in the process of establishing regulations which implement the Oil Pollution Act of 1990. A suggested topic for research would be determination of whether or not these new regulations are adequately designed to avoid the confusion and disagreement over the reimbursement process that occurred in the *Exxon Valdez* case.

Finally, a suggested topic for research would be a comparison of the billing practices followed in the more common transactions in which the Government purchases services and/or material from private organizations with those examined in this thesis. This could include an application of the Cost Accounting Standards to the billings discussed in this thesis in order to determine what impact this would have on the charges assessed to the private corporations.

Appendix A

HOURLY RATES FOR MILITARY PERSONNEL ASSISTANCE

<u>Rank/Rate</u>	<u>Paramount Pictures Provides Quarters</u>	<u>DON Pays BAQ/TAD</u>
O-10	67.79	67.79
O-9	66.66	67.90
O-8	66.23	69.75
O-7	56.20	59.17
O-6	50.41	54.38
O-5	40.49	44.66
O-4	33.70	37.34
O-3	28.60	31.52
O-2	22.32	24.58
O-1	17.58	19.58
W-4	32.97	36.46
W-3	27.32	29.52
W-2	24.78	27.21
W-1	-----	-----
E-9	30.39	33.87
E-8	25.91	28.98
E-7	22.14	24.77
E-6	18.40	20.64
E-5	15.32	16.98
E-4	13.25	14.37
E-3	11.33	12.11
E-2	10.56	11.00
E-1	9.55	9.77
Midshipmen	5.23	5.23

An explanation for the lack of a BAQ/TAD rate adjustment for the O-10 and Midshipmen pay grades could not be obtained.

APPENDIX B

SAMPLE OF REIMBURSEMENT AGREEMENT

(To be composed on production company or studio letterhead)

1. Attached to this agreement is a lists of requirements for the production of "(title)" that the Department of Defense has approved for its official support. This list also contains estimates of the expenses that the U.S. Government expects to incur as a result of providing assistance in support of each of these requirements. (Production company or studio) agrees to reimburse the U.S. Government for all such expenses, and agrees further, in anticipation of such reimbursement, to post (advanced payment or Letter of Credit) to (DoD organization providing support or as appropriate) in the amount of (as applicable).

2. It is understood that DOD property, facilities, equipment and personnel will be made available during the dates and times listed on the attached Detailed DOD Requirements List unless unusual and unforeseen mission requirements prevent such assistance. Minor deviations from the attached schedule may be necessary, but only as agreed to by mutual consent of (production company or studio) and the DON installations and commands concerned.

3. The undersigned have read, understand, and agree to abide by DODINST 5410.16.

4. DoD Components agree to send (production company or studio) invoices via the assigned project officer for the costs and the charges assessed as reimbursement to the U.S. Government for the assistance provided in connection with "(title)" not later than (date). In addition, if the aggregate of such costs and charges is less than the amount hereby posted, the Department of Defense agrees to enclose a check with such invoice in an amount equal to (amount posted), less such charges and costs.

(Signature)

(Date)

(Project Officer Signature)

(Date)

APPENDIX C

DOD REQUIREMENTS LIST

EQUIPMENT, MATERIAL & PERSONNEL REQUESTED	TO BE USED IN SCENE	DATE/TIME	LOCATION	DESCRIPTION OF ACTION	DOD ESTIMATED COSTS

LISTS OF REFERENCES

Baruch, Donald E., Office of the Assistant Secretary of Defense, Memorandum for Director, Audiovisual Entertainment, Chief of Information, Department of the Navy, Subject: Feature Motion Picture "The Hunt for Red October", December 27, 1988.

Boydston, J. L., Captain, USN, Deputy Chief of Staff for Management/Inspector General U.S. Pacific Fleet to Law Offices of Marc L. Goldstein, Subject: Detailed Cost Information Billed in Support of Paramount Production "Top Gun", March 6, 1987.

CG FMFPAC, Naval Message, Subject: Reimbursement for OM,N Costs Incurred in Support of the Exxon Valdez Oil Spill Cleanup, 160213Z OCT 89.

CHINFO, Washington D.C. Naval Message, Subject: Public Affairs-Navy Assistance for Paramount Feature Film "Top Gun", Section 02, paragraph 5, 212240Z Jun 85.

CHINFO, Washington, D.C., Naval Message, Subject: Public Affairs--Charges for Navy Assistance to Paramount Feature Film "Top Gun", 281721Z Jun 85.

CHINFO Washington D.C., Naval Message, Subject: Billing Requirements for "The Hunt for Red October", 071429Z APR 89.

CINCPACFLT Bill No. R0007089SF00016, Detail Information and Cost of Navy Resources in Support of Paramount's Production of "The Hunt for Red October".

CINCPACFLT Bill No. R0007090SF0001, Detail Information and Cost of Navy Resources in Support of Paramount's Production of "The Hunt for Red October".

CINCPACFLT Comptroller, File Name MPN_REV3, Subject: Alaska Oil Spill Costs, Navy MPN Composite Costs, Print Date 17 AUG 89.

CINCPACFLT Comptroller, File Name RATE_REV.WK1, Subject: Alaska Oil Spill-Military Personnel and Ship Maintenance Costs.

CINCPACFLT Comptroller, File Name SPECIAL.WK1, Subject: Alaska Oil Spill - Special/Differential Costs. Fuel Burned/Received. FMFPAC Costs, Print Date 28 FEB 90.

CINCPACFLT to Comptroller of the Navy, Office of Banking and Contract Financing (NCC), Subject: Irrevocable Letter of Credit for Charges for Navy Assistance to Paramount Pictures Corporation, 19 July 1985.

CINCPACFLT, Pearl Harbor, HI Naval Message, Subject: Reimbursement of Costs Incurred in Support of the Exxon Valdez Oil Spill, 142246Z JUL 89.

CINCPACFLT, Pearl Harbor, HI Naval Message, Subject: Reimbursement of Costs Incurred in Support of the Exxon Valdez Oil Spill, 240131Z FEB 90.

CINCPACFLT, Military Interdepartmental Purchase Request, No. Z75160-0000-2101, 06 FEB 1990.

CNO Washington D.C., Naval Message, Subject: Public Affairs--Support for "The Hunt for Red October", 171628Z FEB 89.

CNO Washington D.C., Naval Message, Subject: Reimbursement of Costs Incurred in Support of the Exxon Valdez Oil Spill, 121815Z MAY 89.

COMFITAEEWWINGPAC, San Diego, CA Naval Message, Subject: Charges for Navy Assistance to Paramount Feature Film "Top Gun", 192000Z Jul 85.

COMNAVAIRPAC, San Diego, CA Naval Message, Subject: Public Affairs--Paramount Feature Film "Top Gun", 011258Z Jul 85.

COMNAVAIRPAC, Naval Administrative Message to NAVCOMPT, Washington D.C., Subject: Funding (019): Reimbursement Rate for Private Use of Naval Aircraft F/A-18, 022058Z AUG 85.

COMNAVCRUITCOM, Recruiting Advertising Department, United States Navy Omnibus Survey, July, 1987.

COMNAVCRUITCOM, *Hunt for Red October Impact Survey*, June, 6, 1990.

Department of Defense Comptroller, DoD Invoice 89-97-015, to Department of Transportation, Office of the Secretary, September 8, 1989.

Department of the Navy, Navy Accounting and Finance Center, Memorandum for the Record, Subject: Computation of Reimbursement Rate to be used by CINCPACFLT for the F-14 and Reimbursement Rates for the Use of Navy Aircraft and Equipment, March 12, 1985.

DeWaay, Larry, Executive Producer, "The Hunt For Red October", Letter to Captain Sherman, NAVINFO West, December 19, 1989.

DODINST 5410.15, *Delineation of DoD Audio-Visual Public Affairs Responsibilities and Policies*, November 3, 1966.

DODINST 5410.16, *Procedures for DoD Assistance on Productions of Non-Government Motion Pictures and Television Programs*, January 21, 1964 (now cancelled).

DODINST 5410.16, *DoD Assistance to Non-Government, Entertainment-Oriented Motion picture, Television, and Video Productions*, January 26, 1988.

DODINST 7230.7, *User Charges*, January 29, 1985.

GAO (General Accounting Office), Draft Report, *Millions in Federal Costa May Not Be Recovered From Exxon Valdez Oil Spill*, RCED-91-68, March 1991.

GAO (General Accounting Office), *Exxon Valdez Oil Spill*, B-236137, RCED-90-44, October 30, 1989.

GAO (General Accounting Office), *Exxon Valdez Oil Spill*, B-236137.5, *Exxon Valdez Oil Spill*, January 26, 1990.

Haas, Ronald L., Director, Budget and Management Policy and Procedures Division, Office of Budget and Reports, Unclassified Letter to CINCPACFLT, Subject: CINCPACFLT Support of the Exxon Valdez Oil Spill Cleanup Operation, 19, June 1990.

Inspector General (DoD), Report on the Audit of Assistance to Movie and Television Producers, Report Number 87-008, Project Number 6FD-030, June 6, 1986.

Inspector General, Department of Defense, Report on the Audit of Assistance to Movie and Television Producers, (Report No. 87-008), October 17, 1986.

JTF-AK Elmendorf AFB, AK Naval Message, Subject: DoD Alaska Oil Spill Cleanup Expense Tracking Procedures, 271700Z APR 89.

Kammon, Ralph, Senior Vice President, Paramount Pictures Corporation, letter to Captain Sherman, NAVINFO West, Subject: Paramount Pictures Corporation/"The Hunt for Red October" Hold Harmless Agreement/Use of Naval Facilities, March 27, 1989.

Kannapel, C., Navy Recruiting Command Research and Studies, telephone conversation with author, May 21, 1991.

Hollywood Reporter, January 6, 1988, at 59.

Hollywood Reporter, Telephone conversation between Librarian and author, 3 April 1991.

Lease of Government Landing Craft between United States of America and Exxon, July 28, 1989.

Mizuo, Dennis, Code 03C12, CINCPACFLT, telephone conversation with author, January 24, 1991.

Mizuo, Dennis, Code 03C12, CINCPACFLT, Unclassified Memorandum to author, Subject: Methodology Used to Compute Costs Incurred in Cleanup Operations of the Exxon Valdez Oil Spill, April 29, 1991.

National Westminster Bank USA, Irrevocable Standby Letter of Credit Number 301971, March 30, 1989.

Naval Station Long Beach, Operations, Naval Message to COMNAVSURFGRU Long Beach, PAO Code 014, Subject: Services Rendered in Support of "Hunt for Red October" Filming, December 14, 1989.

Naval Station Puget Sound, telephone conversation with personnel from Comptroller office, April 8, 1991.

Naval Undersea Warfare Engineering Station ,Keyport, WA, Telephone conversation between Budget Officer and author, April 10, 1991.

NAVCOMPT Manual (Department of the Navy, Office of the Comptroller), Volume 3, Paragraph 032102, *Accounting for Deposits Under the Working Fund/Security Deposits Account, Suspense, Navy.*

NAVCOMPT Manual (Department of the Navy, Office of the Comptroller), Volume 3, Paragraph 032109, *Surety Payment Bonds and Letter of Credit.*

NAVCOMPT Manual (Department of the Navy, Office of the Comptroller), Volume 3, Paragraph 035750, *Statistical Costing of Military Personnel Services.*

NAVCOMPT Manual (Department of the Navy, Office of the Comptroller), Volume 3, Paragraph 035875, *Private Parties*.

NAVCOMPT Manual (Department of the Navy, Office of the Comptroller), Volume 3, Paragraph 035881.2a(3)c(2), *Automotive Equipment*.

NAVCOMPT NOTICE 7041, from Comptroller of the Navy, Subject: Composite Standard Military Rates, Basis Allowance for Quarters Rates, and Permanent Change of Station Expense Rates Effective 1 January, 1985, dated 7 March 1985.

Navy Accounting and Finance Center, Memorandum for the Record, Subject: Computation of Reimbursement Rate Per Hour to be Used by CINCPACFLT for the F-14 and Reimbursement Rates for the Use of Navy Aircraft and Equipment, March 12, 1985.

Navy Office of Information, West (NAVINFO West), Memorandum from D. L. Dillon, Director, to Captain Bennett, Subject: Brief Synopsis of NAVINFO West participation in "Top Gun", 4 August 1986.

Navy Office of Information, West (NAVINFO West), Memorandum to CDR Haney, CHINFO (OI-21), Subject: Paramount Top Gun Bill, 1 March 1988.

Navy Office of Information, West to Office of the Chief of Information (OI-3), Subject: Morale, Welfare and Recreation Fund Donations, January 4, 1990.

Navy Office of Information, West to Commander in Chief, U.S. Pacific Fleet, Code 03C, Subject: Final Bill for Reimbursement for Navy Support to Paramount Pictures Corporation for "The Hunt for Red October", January 31, 1990.

Navy Office of Information, West (NAVINFO West) to Chief of Information, Subject: "The Hunt for Red October" After Action Report, February 2, 1990.

Navy Program Factors Manual, (OPNAV Pub 90P-02D).

Office of the Comptroller, Department of the Navy, Memorandum to the Associate Director, Office of Budget and Reports, Subject: 7 NOV 1989 Meeting on Exxon Valdez Oil Spill Cleanup Costs, November 8, 1989.

Office of Deputy Comptroller, (Management Systems), Director of Accounting Policy, Office of the Secretary of Defense, Letter to Comptroller of the Navy, Subject: Costs Incurred by DoD in Support of the Exxon Valdez Oil Spill Cleanup, December 11, 1990.

Paramount Pictures Corporation Letter to Chief of Information, Department of the Navy, Washington, D.C., Subject: "Top Gun" Indemnification Agreement, February 11, 1986.

Raaz, Captain, USN, COMSUBTRAFAC, Telephone conversation with author, 9 April 1991.

Sherman, Michael T., Captain, U.S. Navy, Director, NAVINFO West, Memorandum to Secretary of the Navy, Subject: Donations to Welfare and Recreation Funds for Commands Participating in the Motion Picture "Top Gun", 1 December 1987.

Sherman, Michael T., Captain, U.S. Navy, Director, Navy Office of Information West, telephone conversation with author, March 21, 1991.

Simms, Robert, Assistant Secretary of Defense, Public Affairs, Memorandum for Assistant Inspector General for Auditing, Subject: Response to Draft Report on the Audit of Assistance to Movie and Television Producers (Project #6FD-030) August 06, 1986.

Stairs, Sandra, Lieutenant, NAVINFO West to Bob Manning, OI-22, CHINFO, Subject: Letter from John Horton regarding charges to Paramount Pictures, Paragraph 2, April 1986.

Strub, Philip, Special Assistant (Audiovisual), Office of the Secretary of Defense (Public Affairs), telephone conversation with author, February 21, 1991.

Trodden, Stephen A., Assistant Inspector General for Auditing, Memorandum for ASD(PA), Subject: Report on the Audit of Assistance to Movie and Television Producers (Report No. 87-008), October 17, 1986.

United States General Accounting Office (GAO), *Exxon Valdez Oil Spill*, RCED-90-44, October 30, 1989.

United States General Accounting Office (GAO), *Exxon Valdez Oil Spill*, B-236137.5, January 26, 1990.

United States General Accounting Office (GAO), Draft Report, *Millions in Federal Costs May Not Be Recovered From Exxon Valdez Oil Spill*, March 1991.

USS GEORGE PHILIP Naval Message to COMNAVSURFGRU Long Beach, CA, Subject: Billing for Hunt for Red October Operations, 122145Z Dec 89.

Wattles, Joshua S., Senior Vice President and Deputy General Counsel, Paramount Pictures Corporation, Letter to Commander in Chief, United States Pacific Fleet, Fleet Comptroller Office, July 15, 1985.

Wattles, Joshua S., Senior Vice President and Deputy General Counsel, Paramount Pictures Corporation, Letter to Chief of Information, Subject: "TOP GUN" Indemnification Agreement, February 11, 1986.

INITIAL DISTRIBUTION LISTS

	No. Copies
1. Defense Technical Information Center Cameron Station Alexandria, VA 22304-6145	2
2. Library, Code 52 Naval Postgraduate School Monterey, CA 93943-5000	2
3. Professor K. J. Euske, Code ASEE Naval Postgraduate School Monterey, CA 93943-5000	1
4. Lt. James Brooks, USN Navy Office of Information West 11000 Wilshire Blvd. Suite 11100 Los Angeles, CA 90024-3691	1
5. Captain R. Osterhoudt, USN Office of the Comptroller Commander in Chief, U.S. Pacific Fleet Pearl Harbor, HI 96860-7000	1
6. Mr. Dennis Mizuo, Code 03C12 Commander in Chief, U.S. Pacific Fleet Pearl Harbor, HI 96860-7000	1
7. Mr. Bill Schilling, Code NCB-522 Department of the Navy Office of the Comptroller Washington, D.C. 20350-1100	1

8. Lt. Michael Conn, USNR
510 South James Street
Sparta, IL 62286

1